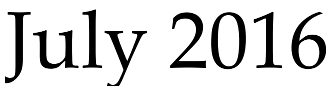

FIELD COURT TAX CHAMBERS

FIELD COURT TAX CHAMBERS

Contents

Current Rates .... Latest rates of inflation and interest

Trading in UK Land……………..…...……………………...HMRC issue guidance on the new rules

EIS Relief ……………………………………….…...…The rules are increasingly difficult to satisfy

Security for PAYE…………………….....…………The Tribunal decides that hardship is relevant

Receivers and Group Relief...……………...…………...The effect of the appointment of a receiver

Presumption of Continuity...……………………...…………...This argument has not gone away

Latest Rates of Inflation and Interest

The following are the current rates at July 2016

Current Rates	
Retail Price Index: June 2016	263.1
Inflation Rate: June 2016	1.6 %
Indexation factor from March 1982:	
to May 2016	2.299
to June 2016	Not yet published

Interest on overdue tax

Interest on all unpaid tax is charged at the same rate.

The formula is Bank base rate plus 2.5% which gives a present rate of 3%.

There is one exception: Quarterly instalments of corporation tax bear interest at only 1.5%.

Repayment supplement

Interest on all overpaid tax is payable at the same rate.

The formula is Bank base rate minus 1% but with an overriding minimum of 0.5% which applies at the present time.

Official rate of interest

To 6 April 2014: 4%

To 6 April 2015: 3.25%

From 6 April 2015: 3%

FIELD COURT TAX CHAMBERS

Trading in UK Land

Anybody who is waiting to see what is going to happen about the proposals for the taxation of land in the UK, regardless of where the company is resident (and whether or not it has a permanent establishment), might like to know that the law is already in force. It came into force on 5th July and includes a targeted anti-avoidance rule which applies with effect from 16th March 2016. No, it has not been enacted yet, but they only have to say the word "tax" and the normal rules seem to go out of the window. It makes you wonder why we bother to have laws at all, if obeying them has the same consequences as breaking them.

Anyway, I took some time out from my search for Pokemon Go characters to read the very helpful guidance note published HMRC on how these new rules will operate. Usually, we have legislation which is then explained by the guidance notes. Now we have a guidance note first.

The guidance notes start by explaining that generally, capital gains tax is only charged on UK residents – with two exceptions. Residential property in the hands of non-residents which is chargeable under the rules introduced in 2015; and assets used by a UK permanent establishment of a non-resident company for the purposes of a trading activity. (section 10B TCGA 1992). As far as trading profits are concerned, when a trade is being carried on in the UK a by a non-resident company through a permanent establishment the trading profits are chargeable to corporation tax here.

Under the new rules, non resident companies can be taxed on profits from trading or developing UK land regardless of whether they have a PE in the UK. The whole of the profit will be taxable here and not just the amount which would have been attributed to the UK PE. The idea is for the profit to be taxed in the same way as a UK resident company.

The targeted anti avoidance rule will take the positon further by bringing into charge profits which are not subject to the new charge. (This looks a tad alarming; we will tax you if you fall within the legislation and we will also tax you if you don't. This seems to be a recurring theme). And where there is fragmentation and what they call disguised trading through envelopes (or entities which do not have a separate legal personality) there are special rules to bring those profits into charge to UK tax. These new rules are intended to complement the seriously complex provisions of section 815 et seq Corporation Tax Act 2010 relating to transactions in land.

Sometimes the liability to tax in the UK will be eliminated by a double tax agreement but HMRC are trying to prevent that as well. Not so easy when you have an international agreement, although they have already "adjusted" the treaties with the Channel Islands.

I am afraid that this goes on and on – this is the briefest summary I can manage - so there is some serious work to be done where foreign clients are contemplating trading or developing land in UK.

FIELD COURT TAX CHAMBERS

EIS Relief

The EIS is a very valuable relief but it has become increasingly difficult to claim having regard to the numerous and incredibly tight conditions which have to be satisfied; and they get worse.

One of the conditions for the EIS is that the relevant shares do not carry "any present or future preferential right to a company's assets on its winding up": section 173(2)(aa) Income Tax Act 2007. In the case of *Flix Innovations Limited v HMRC* TC 4710 the company had undertaken a bona fide commercial reorganisation of its shares which involved the creation of some valueless deferred shares which carried the right to the return of their nominal value (£0.0001 each) on a winding up, after the ordinary shares had been repaid. The very nature of deferred shares is that they stand behind the ordinary shares. However, if you have a class of shares which stands behind the ordinary shares, that must mean the ordinary shares have a preferential right. That means your EIS relief on the ordinary shares is disqualified.

The First Tier Tribunal had acknowledged that the amounts were small but did not consider that the preferential right could be disregarded. If Parliament had intended small or insignificant preferential rights to be ignored they would have said so. Despite the fact that HMRC say in their manuals that this is a matter of degree and a purely theoretical right to a residue of assets in the winding up would not be regarded as a preferential right, they argued exactly the opposite in court. The Tribunal agreed with their view.

The Upper Tribunal [2016] UK UT 0301 has now also had a go and they have confirmed that it is not a question of degree. The existence of "any" preferential right excludes the application of the EIS.

It is inadequate to describe this as a trap for the unwary – it is so much worse than that, and one might wonder whether Parliament could possibly have intended the relief should be denied so capriciously. However, the Upper Tribunal explained that a purposive interpretation was impossible in the circumstances. The legislation is so closely articulated that to ignore the preferential rights carried by the ordinary shares would be to rectify the language of the statute rather than to construe it purposively.

It is interesting to compare this reasoning with the Supreme Court judgment in DB and UBS where quite a lot was said about purposive construction. The Supreme Court suggested that if it makes no sense, has no commercial relevance and could not be what Parliament intended, a purposive construction should be available. Or using their own words, an appropriate purposive construction could be adopted to interpret the legislation in the light of the transaction that took place. This was in the context of the definition of restricted securities in section 423 ITEPA 2003 which could hardly be more closely articulated. Um.

This conclusion will probably cause EIS relief to be denied to people who have made perfectly commercial and reasonable investments relying on the views expressed by HMRC in their Manuals. It may also be a source of negligence actions against advisors who may not have expected EIS relief to be denied in these circumstances.

I guess the lesson here is that if you invest in an EIS company which has more than one class of shares, you are likely to be in trouble. Or if the company issues a new class of shares, you are also likely to be in trouble. If there is more than one class of shares, one is bound to have rights which are preferential to the other. If not, why on earth have different classes? Accordingly, you need to examine the articles extremely carefully to see what these comparative rights are because if there is the slightest differential in the share rights, you had better make sure that your shares are not the ones which have any conceivable preference when it comes to a winding up.

Security for PAYE

The power of HMRC to require security for PAYE and NIC is truly awesome. The principle is fair enough and we have seen it in the context of VAT for many years. Under Schedule 11(4) VAT Act 1994, HMRC are entitled to seek security from the taxpayer if they think it necessary for the protection of the Revenue, for example if he has failed to comply with his VAT obligations or HMRC have reason to believe that he might fail to do so. This is really serious because it is a criminal offence to continue to make taxable supplies if you have not provided the security demanded by HMRC.

Of course, if a person is unable to pay his current VAT liabilities, he is hardly going to be able to pay a security representing a few months' VAT liabilities in advance. So to avoid criminal liability, he must cease to trade.

The PAYE rules for security are more recent – and are much worse. Regulation 97N of the PAYE Regulations provides that where an officer of HMRC considers it necessary for the protection of the Revenue, he may require the company, or the directors, to provide security for payment of the PAYE in the future. The failure to provide security is a strict liability criminal offence which is punishable by a fine of **unlimited** amount. (I am not joking). I think it was generally understood that the maximum fine was £5000 but the Tribunal explained very carefully that this limit does not apply here. (Mind you, I think the prospect of a criminal conviction is likely to be much more important that the amount of the fine). Ceasing to trade does not help; the criminal offence applies if you fail to pay the money. There is virtually no defence to a strict liability offence.

Fortunately, and unlike the position for VAT, there is a right of appeal against a security notice for PAYE and NIC. The Tribunal is entitled to form its own view and to confirm, set aside or vary a security notice.

Having regard to the enormity of the consequences – with directors facing criminal liability and an unlimited fine for failing to provide the necessary security when the company is up to their ears in debt and has no access to funds - it is no surprise that this is ended up in court: *D-Media Communications Limited v HMRC* TC 5183.

The Tribunal noted that the recipient of a notice to provide security will be criminally liable merely for the failure to provide the security. If that person simply does not have the funds, the inevitable consequence of the issue of a security notice will be that a criminal offence will be committed. No doubt influenced by the harshness of this rule, the Tribunal suggested that hardship should be a factor in the decision of HMRC to require security.

They said that a policy which dictates the amount of security to be required without regard to the ability to pay is inconsistent with the legislation. If the taxpayer cannot pay, and HMRC know they cannot pay, to require the taxpayer to provide security which they would inevitably fail to do and be criminally liable, can do nothing to protect the Revenue and cannot have been the purpose of Parliament in making these regulations. Accordingly, the Tribunal reduced the amount of the security to manageable proportions.

To make a person criminally liable for non-payment of tax is bad enough – but to make them criminally liable for non-payment of a liability which has not yet arisen, just because HMRC are worried about it, is a very serious power indeed. It clearly deserves some control by the courts – and this case shows how badly such control is needed.

Receivership

The recent case of *Farnborough Airport v HMRC* TC 5184 was concerned with the effect on a group relief claim of a company going into receivership.

In this case, one of the companies in a group made a loss which was surrendered to another company in the group. The company with the loss had borrowed money from a bank which had a charge over the company's assets and in due course, a receiver was appointed "over the whole of the property of the company" pursuant to that charge. The question was whether the appointment of the receiver caused the subsidiary to cease to be a member of the group and therefore unable to surrender its losses to other members of the group. The key provision is s.154(3) Corporation Tax Act 2010 which provides as follows:

> "At some time during or after the current period, a person (other than the first or second company) has or could obtain, or persons together (other than those companies) have, or could obtain, control of the first company but not of the second company".

One might start with the proposition that a company to which a receiver is appointed does not lose the beneficial ownership of its assets. Accordingly, one might think that this would be enough to protect the group relief position; unfortunately not. What needs to be considered here is the straightforward question of whether the parent continued to control the subsidiary. HMRC take the view that the appointment of a receiver causes the shareholders to lose control of the company thereby breaking the group relationship and denying any benefit of group relief.

Despite valiant efforts by the company to demonstrate that the provisions of s.154 should be construed to avoid some mischief, the Tribunal concluded that the words and the purpose behind the words of s.154 were clear. It is not an anti-avoidance provision; it simply sets out the conditions for group relief. Those conditions specifically provide that group relief is unavailable between companies which are not under the same control.

The meaning of control for this purpose is that found in section 1124 CTA 2010 being the power over the conduct of the affairs of the company. Accordingly, it was necessary to consider whether after the appointment of the receiver, the parent continued to have the power to secure that the company's affairs were conducted in accordance with its own wishes. The Tribunal decided that once the receiver had been appointed, it did not, and that was sufficient for it to cease to have control and therefore to fall outside the group.

In this case, the argument was straightforward because the charge document gave the receiver power over "the whole of the property of the company" – but this will not necessarily apply in another case where the receiver is appointed in respect of a single asset. In those circumstances, I would suggest there may be a completely different outcome.

A difficult point might be thought to arise where there is a charge over the company's assets, because there is always the possibility of a receiver being appointed in the event of a default. Accordingly, it could hardly be denied that some time after the current accounting period control would be lost so the very existence of the charge would disqualify the company from group relief. Fortunately, section 154(3) provides that these consequences do not apply to a mortgage which on default will give rise to the rights, – at least not until such time as the mortgagee has exercised his rights. Nevertheless, there is clearly danger in respect of any other kind of arrangements.

Presumption of Continuity

This subject has popped up again. It may be remembered that in the case *Syed v HMRC* TC 1776, there was some negotiation between the taxpayer's accountants and HMRC regarding deductible expenditure and the accountants eventually agreed some adjustments to the computations.

No big deal you may think – it sounds quite routine - except that HMRC then said that they were going to raise assessments for previous years on the *presumption of continuity*. This is a term which derives from the case of *Jonas v Bamford* 51 TC 1 in which the High Court said:

> "Once the inspector comes to the conclusion that on the facts which he had discovered that Mr Jonas had additional income beyond that which he had so far declared to the inspector, then the usual presumption of continuity will apply. This situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer".

It will be observed that this presumption applies only for the position in the future. Even the HMRC Manuals do not suggest that the presumption of continuity can be used to reopen earlier years.

The Tribunal said that the argument of HMRC was quite wrong. Nevertheless, HMRC kept on trying to assess earlier years on this basis and in *William Chapman v HMRC* TC 1593, their arguments were again rejected specifically on the basis that the presumption does not apply to earlier years. Undeterred, HMRC carried on and again in *Aero Assistance Logistics Limited v HMRC* TC 2628, the court told them that the argument is wrong.

There is something seriously unsatisfactory about HMRC continuing to advance an argument which the courts keep telling them is wrong. Maybe they were just hoping that if they keep on going, eventually they will get a decision in their favour.

Well, goodness me. Last week in the case of *G Allan v HMRC* TC 5260 the Tribunal said that "the presumption of continuity applies in the raising of assessments for earlier years" and upheld assessments for earlier years.

The taxpayer was not represented.

I wonder what conclusions can be drawn from this.

Peter Vaines
Field Court Tax Chambers
29th July 2016

Contact
Peter Vaines
Field Court Tax Chambers
3 Field Court
Gray's Inn
London WC1R 5EP

Tel: 020 3693 3700
pv@fieldtax.com
www.fieldtax.com

© Peter Vaines   All Rights Reserved   July 2016

This bulletin is prepared for private circulation and no unauthorised reproduction of any part thereof is permitted. The contents of this bulletin are intended to highlight points of current interest for the purposes of discussion only and do not represent a full review of any subject. Professional advice should always be sought in respect of any matter referred to herein and no liability is accepted by the author for any action which may be taken, or refrained from being taken, on the basis of the contents hereof. The views expressed in this bulletin are those of Peter Vaines alone and are not necessarily shared by any other member of Field Court Tax Chambers.