UK Tax Bulletin

February 2017

Field Court Tax Chambers

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FIELD COURT TAX CHAMBERS

Latest Rates of Inflation and Interest

The following are the current rates at January 2017

Current Rates	
Retail Price Index: January 2017	265.5
Inflation Rate: January 2017	2.6%
Indexation factor from March 1982: to December 2016 to January 2017	 2.362 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 2.75% from 23rd August 2016

There is one exception: Quarterly instalments of corporation tax bear interest at only 1.25% from 16th August 2016

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%

New Non Dom Rules

The starting date for the new non dom rules comes ever closer, creating ever more anxiety. The difficulties arising with the proposed rules keep on growing – but maybe things will get clearer after the Budget next week. Maybe.

Some points were clarified recently by the various professional bodies following their detailed discussions with HMRC.

HMRC have confirmed that the latest version of the draft legislation published on 26th January was intended to ensure that rebasing will be applicable to offshore income gains.

There are loads of uncertainties over cleansing – that is the unmixing of a mixed fund. HMRC have clarified one of them by confirming that this cleansing only applies for the application of section 809Q(3) Income Tax Act 2007. What this means is that because section 809Q only applies with effect from 6th April 2008, it cannot therefore apply to pre 2008 mixed funds - so those earlier mixed funds are not eligible for relief under the new cleansing rules.

The clauses which provide the various trust protections are really difficult and one crucial element is the possibility of tainting – because if you taint an existing offshore trust, it will lose its protection from income tax and capital gains tax. The general idea is that all the anti-avoidance provisions are going to be turned off and the income and gains will not be chargeable to tax unless and until they are distributed from the offshore structure. But this protection will not apply if the trust is tainted.

Such tainting will occur if the settlor makes an addition to the trust; if somebody else makes an addition that will not destroy the protections – but it would cause that new settlor a whole load of problems. One area of concern is whether a non commercial loan to the trust which is already in existence (eg a loan which is interest free or at a low rate) would taint the trust and completely wreck its tax position.

HMRC have said that is exactly the position. They specifically confirm that a non-commercial loan to a trust before 6th April 2017 which remains outstanding on or after that date will be regarded as the provision of property for the purpose of the settlement. This is code for saying it will be an addition to the trust and therefore represent tainting.

However, there is going to be a transitional provision so that this will not apply if before 6th April 2018, the loan is either repaid in full together with any outstanding interest, or is made subject to fully commercial terms including a commercial rate of interest payable at least annually from the year ending 5th April 2018. It will be necessary for interest at a commercial rate to be paid in respect of any loans during the year ended 5th April 2017.

This is all a bit troublesome – which I guess that is the general idea - but at least we will have a year to deal with it. I suppose we should be grateful for the transitional relief.

Reasonable Excuse

HMRC are not keen on accepting that reliance on an agent or accountant who deals with your tax return (and whose error gives rise to a penalty) can represent a reasonable excuse. Fortunately, the courts do not usually share their reluctance.

This issue seems to have settled down into the proposition that a taxpayer who relies on a reputable advisor for advice in respect of his tax affairs will not be liable to a penalty if they get something wrong. A person who perceives the need to take professional advice and relies on that advice, will not be negligent even if the advice turns out to be wrong. However, if the taxpayer has reason to believe the advice may not be correct, he will not be protected if he just closes his eyes to those doubts and hides behind the advisor.

The recent case of *David Steiner v HMRC* TC 5650 brings a new dimension to this subject. In this case, Mr Steiner's tax return was dealt with by his accountant. When he changed accountants, they reviewed the position and decided that there were errors in his tax return. They corrected the errors and Mr Steiner made a further payment of tax. HMRC imposed a penalty.

Mr Steiner claimed that a penalty should not arise because he had a reasonable excuse. He had followed the advice of his accountant and as soon as the error was discovered by his new accountants, the matter was corrected. The tribunal did not accept that a reasonable excuse existed. They did not reject it in principle, but because of a lack of evidence. No details were provided of the mistake, how and why it was made, and there was nothing to show that the conditions for the existence of a reasonable excuse existed.

The principle therefore appears to be safe but the tribunal clearly needs more than a general statement that it was the accountant's fault. They need sufficient evidence to satisfy them that the taxpayer did behave reasonably in relying on his accountant's advice.

ATED

The amount of the ATED charge is based on the value of the relevant property at various value thresholds. The charge starts to apply at £500,000 (where the ATED charge is £3,500) and rises to a threshold of £20 million (where the charge is £218,200 and going up to £220,350 on 1st April).

These thresholds are presently based on the value of the property on 1st April 2012. The values are revised every five years so that for 2017/18 the ATED charge (which will be payable on 1st April 2017) will be based on the values of the properties at 1st April 2017.

I guess that in early April, the Zoopla website may crash with everybody trying to find out the value of their properties for ATED purposes.

Penalties: Losses

Where somebody does something (or fails to do something) and it results in a penalty, the penalty is sometimes related to the amount of tax involved – which is called the potential lost revenue.

One might therefore take the view that if there is no tax involved – for example the subject matter of the penalty involves losses which are carried forward - there is nothing to worry about.

The recent case of Simon Fry v HMRC TC 5651 explains that this is not the case – and highlights how penalties are worked out where losses are involved. Mr Fry had wrongly claimed a capital loss; he was found to have been careless in doing so and a penalty was imposed by HMRC.

I cannot imagine anybody would be interested in all the details – so maybe I will just say that where the losses have been utilised, there will obviously be a potential loss of revenue, so the figure will be clear. However, where the loss has not been used and is carried forward, the potential lost revenue will be treated as 10% of the amount of the loss - unless there is no reasonable prospect of the loss being used, in which case the penalty will be zero.

Negative Earnings

In 2014, the Tribunal decided that a measure of relief from income tax was available to a Mr Julian Martin who had received earnings which were subsequently clawed back by his employer: HMRC v Julian Martin [2014] UKUT 429. Mr Martin had taken a job paying him a signing on bonus of £250,000 with the proviso that some of it would be clawed back if he left the employment within five years. He did, and had to repay £162,500. Unless he was able to get a tax deduction for this amount, he was going to end up out of pocket because the amount repaid would exceed the net amount of the earnings.

HMRC acknowledged that this could mean that the taxpayer could be worse off than if he had never had the bonus at all - but said it was nothing to do with them. They just had to apply the law. They always say that when the unfairness is in their favour – but when it is in the taxpayers favour they complain like mad, usually claiming that it is “contrary to the intention of Parliament”. A balanced approach would be welcome.

Anyway, the Tribunal said they were astonished that there was no guidance in the legislation about negative taxable earnings in Section 11 ITEPA 2003 – what they are and how you calculate them. However, the Tribunal could "barely think of a more obvious example" of negative taxable earnings than in this case. Although the amount repaid was not a loss, it could be deducted from his other income in the same tax year.

HMRC have now published some guidance on the subject of negative earnings although they seem only to cover the circumstances of a clawback in the event of a resignation. However, there are increasing number of occasions in the financial sector where a clawback may arise for other reasons, such as misconduct, where exactly the same considerations could apply.

In addition, HMRC suggest that negative earnings must arise from an event relating to the employment so (for example) a payment for the breach of a restrictive covenant might not be eligible for relief.

The guidance helpfully enables us to understand how HMRC are likely to approach the matter but there would still seem to be plenty of scope for disagreements (and unfairness) in this area.

It may be that having regard to the obvious uncertainty (and potentially disastrous consequences) over the tax treatment of any such clawback, employees are likely to insist upon any clawback clause being calculated on a net basis.

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