UK Tax Bulletin

November 2015

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Introduction

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

Autumn Statement: .... Mr Osborne makes a speech

Non Doms: .... More details are revealed

Employee Benefit Trusts: .... Rangers lose in the Court of Session

Discovery Assessments: .... The UT goes back to first principles

Main Residence Exemption: .... A further case to add to the list

Ordinary Residence: .... A famous victory for the taxpayer

UK Source Income: .... The UT provides further guidance

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Latest Rates of Inflation and Interest

The following are the current rates at November 2015

Current Rates	November 2015
Retail Price Index: October 2015	259.5
Inflation Rate: October 2015	0.7%
Indexation factor from March 1982: to September 2015 to October 2015	 2.268 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%

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Autumn Statement 2015

The Chancellor of the Exchequer said many important things in his Autumn Statement on 25 November but I am afraid I did not find much of it particularly interesting – although clearly there is some stuff on the horizon.

It would be nice to have more details of the SDLT proposals where somebody invests in an investment property or acquires a second home. It seems that from 1 April 2016 the rates for such property will be increased by 3% above the current SDLT rates. This will apply to every tier up the scale from zero for under £125,000 to 12% over £1.5 million – although it looks like the first £40,000 will be free.

Residential property is in for some further hammering from capital gains tax. It is suggested that from April 2019 payment of capital gains tax on the disposal of a residential property will need to be made within 30 days of completion.

For residential properties taxable under the Non Residents CGT rules, there are to be some amendments to remove a possible double charge – and to relieve some people from having to file returns.

The changes to Entrepreneurs Relief earlier this year have generated some criticism and they too will be amended to prevent the loss of the relief to genuine commercial transactions.

There are some anti avoidance provisions relating to intangible assets and capital allowances and a proposal to amend the Transactions in Securities legislation in Section 682 of seq ITA 2007 by introducing a targeted anti avoidance rule. This looks odd because I thought the existing legislation was a targeted anti avoidance rule. A special targeted provision sounds like it will address a narrow issue – but I bet in this case it will widen the scope of the present rules.

It is also proposed that there will be swingeing penalties (up to 60%) on tax found payable after a successful GAAR challenge by HMRC. We have not seen any GAAR referrals yet but they cannot be long now. Surely HMRC will not be able to resist such a mouth watering prospect of a 60% penalty.

It is possible that more details of these measures will be revealed when the draft legislation is published next week.

Non Doms

In previous Bulletins I have explained the various proposals published by HMRC to amend the taxation of non doms from 6 April 2017. These are extremely wide ranging and some important details remain unclear. We are hoping for some further clarification on this subject next week when the draft legislation is to be published – but some recent discussions with HMRC indicate that we may be disappointed.

Meetings took place on 9 October and 26 October with HMRC and the professional bodies and the notes of those meetings reveal both uncertainty and confusion – particularly in relation to the proposed taxation of trusts after 6 April 2017.

It may be remembered that when a person becomes deemed domiciled having been resident in the UK for at least 15 out of the last 20 years, they will be regarded as domiciled for all tax purposes and unable to benefit from the remittance basis even by paying the non dom charge.

As far as offshore trusts and companies are concerned it is suggested that any income within the offshore structure would not be taxable under the normal anti avoidance provisions but tax would arise if any distributions were made. The question is – how will this tax arise? If they receive a distribution, will this be taxed as income, or capital – or what? And what if the trust has no income or gains? Answer : don't know.

We might have expected some further guidance on this point but now they say that a preliminary draft of the legislation will be published prior December 2016.

As far as returning non doms are concerned (that is, those individuals born in the UK with a UK domicile of origin who have subsequently acquired a foreign domicile), they will be deemed to be UK domiciled for all UK taxes in any year that they are UK resident. This creates a real problem with trusts which may have been established decades ago because they might (and probably will) become liable to a 10 year charge. HMRC said they are not sure what will happen here.

Not a lot of light amid the darkness here, then.

The only bit of comfort I could find in these notes is the confirmation by HMRC that if a trust were to be established before 6 April 2017 (even if this is done in the taxpayer's 16th year of residence) then the trust would benefit from the new trust regime for income tax and capital gains tax – except that we do not know what the new regime is going to be.

Stay tuned.

Employee Benefit Trusts

The decision has now been published in the case of *Advocate General for Scotland v Murray Group Holdings Ltd [2015] CSIH 77* which related broadly to the tax treatment of payments made to a trust for the benefit of the employees of Rangers Football Club. This is a seriously hot potato.

The company had established an Employee Benefit Trust and there were numerous sub funds for the benefit of the employees and their families.

HMRC claimed that payments to the trust represented earnings of the employees which should have been subject to PAYE and NIC and this claim had very far reaching consequences for Rangers Football Club. However, the First Tier Tribunal and the Upper Tribunal said that HMRC were wrong and no liability to tax arose on the grounds that the trustees of the EBT had a genuine discretion about the application of the funds. Accordingly, the amounts paid were not earnings and this conclusion was supported by impressive authority.

The Court of Session did not agree and in a lengthy judgment distinguishing earlier Supreme Court and other authority, held that the payments to the trust were consideration for the services of the employees and taxable as earnings. A crucial element of the judgment was the conclusion that:

> *"If income is derived from an employee's services qua employee, it is an emolument or earnings and is thus assessable to income tax, even if the employee requests or agrees that it be redirected to a third party".*

The Court found that such redirection had indeed taken place and the liability to income tax followed.

The Court went on to say that payments out of the trust would not be taxable because the funds would be held by the trustees as capital and the payment out of the trust would be treated as a capital payment for tax purposes. It is difficult to understand the reasoning here – and why for example, Part 7A ITEPA 2003 would not apply to such payments.

Supreme Court here we come, I think.

Discovery Assessments

Discovery cases are always important (and usually interesting) and the decision of the Upper Tribunal in *Burgess v HMRC (2015) UKUT 0578* is no exception as it examines a new dimension to the issue.

HMRC claimed (rightly) that the taxpayer had not disclosed all his profits – and suggested that this was a deliberate omission. They issued discovery assessments. The First Tier Tribunal held that the onus of proof was on the taxpayer to displace those assessments in the normal way but Mr Burgess argued that this was the wrong approach. Although he had the burden of proof on the substantive issue relating to the adequacy of the profits etc, HMRC had the burden of proving that the assessments were valid because they were issued outside the time limit for assessments, unless a discovery assessment could properly be made.

The Upper Tribunal considered that the assessments could not stand because HMRC had not discharged their burden of proof. This may be regarded as extremely unsatisfactory because the taxpayer had materially understated his taxable profits which would now not be taxed. However, the Tribunal explained the important principles in connection with the relationship between the State and the citizen in respect of discovery assessments:

> "*It must be recognised … that the assessment system that Parliament has legislated for is designed to provide a balance between HMRC and the taxpayer. Part of that balance is the requirement, in relation to discovery assessments outside the normal time limits, that HMRC satisfied the FTT that the relevant conditions for those assessments to have been validly made had been met. If HMRC fail to do so, for whatever reason, the fact that a taxpayer might escape tax that would otherwise have been due is simply the consequence of the operation of the system that provides such a balance. It is not for this Tribunal to achieve any result other than that prescribed by the law.*"

I think that it may prove extremely helpful to have these principles expressed so clearly particularly in cases which have rather more intrinsic merit than *Burgess*.

Main Residence Exemption

This is also a subject where there is a superfluity of authority – not all of which is consistent or helpful.

The key issue is of course whether the relevant property is the individual's only or main residence – but crucially, it has to be "a residence" before it can be a main residence – or before the election can be made for that purpose under Section 222(5) TCGA 1992.

It has become increasingly difficult for a property to qualify as a residence. We know (from Lord Widgery in *Fox v Stirk*) that a residence means:

- the place where a man is based or continues to live;
- where he sleeps, shelters and has his home;
- something other than temporary accommodation;
- there is some expectation of continuity with a degree of permanence.

It is instructive to consider the case of *Susan Bradley v HMRC*. Mrs Bradley lived in a house owned jointly with her husband but she also owned another small house and a flat both of which had been let. She moved out of the matrimonial home in August 2007 (preparatory to a divorce) and in April 2008 moved into the small house. She repainted it, made improvements and

generally made it more of a home. Although she put the property on the market, the market was very poor and she expected to live there permanently. However, in the Autumn of 2008 Mr and Mrs Bradley were reconciled and she moved back into the matrimonial home in November 2008 and the small house was sold in January 2009.

So during the period April 2008 to November 2008 the small house was her only residence and when it was sold she claimed the exemption. However, the Tribunal said that she did not occupy the property as her residence, because she never intended to live permanently in the property; it was only ever going to be a temporary home and therefore it was never her residence.

This contrasts with the case of *David Morgan v HMRC*. Mr Morgan was purchasing a property where he intended to live when he and his fiancée were married. He had sold his own flat and moved in with his fiancee's family but unfortunately two weeks before the purchase, the relationship ended. He went to live with his parents. He carried on with the purchase of the property and moved in for two weeks specifically to prepare the house for renting and then moved back to live with his parents. The property was let and eventually sold. The Tribunal decided that Mr Morgan had lived in the property for two weeks and this was enough for it to qualify as a residence.

One might consider that both these cases were wrongly decided – and then we had the case of *Piers Moore v HMRC*. Mr Moore also had matrimonial difficulties and moved into another property taking furniture with him from the matrimonial home. He took all his clothes knowing that he would never return. He lived there from November 2006 to July 2007, spending pretty much every night there except when he was away on business. The Tribunal found that he did not occupy the property with a sufficient degree of permanence for it to be a residence. It was only temporary accommodation.

This is all very difficult.

We now have the case of *Dutton Forshaw v HMRC TC 4644* which gives us some more to go on. Mr Dutton Forshaw had owned and lived in loads of properties. In the end, the issue was whether the property in which Mr Dutton Forshaw lived for the 7 weeks from 5 August to 25 September 2006 was a residence. Having regard to the obvious temporary nature of the accommodation one might have thought HMRC were on strong ground for claiming that this was not a residence at all. However, the Tribunal was extremely sympathetic. They took the view that if this was not the taxpayer's residence for these dates, he would have had no property which was his residence during the period and they thought that would be a surprising result. (It did not seem to be at all surprising in any of the other cases – but never mind).

Accordingly, they decided that although he only lived in the property for 7 weeks, there was sufficient permanence or continuity for it to have been his residence and the exemption was allowed.

Although it might be reasonable to say that this was just one more case decided on its own special facts and gives no real help in any other case, the Court did have some helpful statements to make regarding the principles involved – not least to reiterate the view of the FTT in *Regan v HMRC* that the need for permanence or continuity should not be overstated.

Ordinary Residence

The recent case of *Carey v HMRC TC 4634* considered the rules relating to ordinary residence prior to the introduction of the Statutory Residence Test. Mr Carey had made a claim under Section 131 ITA 2007 for an allowable loss in 2011/12 but this required him to be ordinarily resident during the year. It was agreed that Mr Carey was not resident for 2011/12 and the question was whether he had retained his ordinary residence thereby enabling him to qualify for the relief.

The FTT decided that although Mr Carey had gone to Rwanda and had become resident there with effect from January 2011, he had not ceased to be ordinarily resident in the UK until December of that year. Accordingly, because he was ordinarily resident for part of the year, he was therefore ordinarily resident for the whole of the year and entitled to the relief.

A great result for Mr Carey (and his representative).

Numerous references were made by the FTT to the case of *Genovese v HMRC (2009)* but I was surprised that there was no reference to the decision in *Tuczka v HMRC (2011) UKUT 113*. In the case of *Tuczka*, HMRC made some significant criticisms of the decision in *Genovese* and the Tribunal accepted that the Tribunal in *Genovese* had failed to take into account existing authorities on the matter.

On a more general note, the Tribunal concluded that an individual can be ordinarily resident while being non resident. This is a controversial matter as it is widely thought that you cannot be ordinarily resident unless you are resident – i.e. ordinary residence is a sub-set of being resident. Although Section 2 TCGA 1992 is drafted on the basis that you can be ordinarily resident while being non resident, the Courts have not reached a consistent view on the matter.

Although the concept of ordinary residence has been largely abolished with the advent of the Statutory Residence Test from 5 April 2013, it still has an application for National Insurance contributions and of course it will be relevant to those cases (like this one) which relate to events prior to April 2013.

UK Source Income

The recent case of *Ardmore Construction Limited and Perrin v HMRC (2015) UKUT 633* was concerned with the meaning of income arising in the UK and therefore whether it was subject to the deduction of tax at source. The classic authority on this matter is the celebrated case of *Westminster Bank Executor and Trustee Company (Channel Islands) Limited v National Bank of Greece S.A. 46 TC 472*.

In the Greek Bank case the debtor was a foreign company; it was guaranteed by another foreign company, secured on foreign assets and payment was to be made outside the UK to persons outside the UK. The only reason that anybody suggested that the interest should be regarded as arising in the UK is that the guarantor subsequently acquired a branch in the UK and for various practical reasons the only place in which the guarantee could be enforced was London.

The House of Lords decided that the interest did not arise in the UK and their Lordships did not see how the obligation which started in Greece could subsequently move its location.

Over the years HMRC developed their thinking on this subject and the latest version of their view is set out in their Manuals; whether income has a UK source depends on a number of factors namely:

- (a) the residence of the debtor;
- (b) the location of the debtor's assets;
- (c) the place of performance of the contract and the method of payment;
- (d) the competent jurisdiction for enforcement;
- (e) the proper law of the contract;
- (f) the location of the security for the asset.

HMRC consider that the residence of the debtor is the most important factor along with the location of the debtor's assets because that will be where the creditor will sue for payment. They also say that the residence of the debtor is residence for the purposes of jurisdiction.

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The Upper Tribunal considered the Greek Bank case in detail and concluded that residence was not the most important factor. Furthermore, there is no support for the proposition that there was a link between jurisdiction and residence. This seems directly contrary to the approach of HMRC.

In this case, Mr Perrin had received loans from a trust in the Isle of Man and the question was whether the interest payable on those loans was interest arising in the UK. Mr Perrin was resident in the UK. However the proper law of the agreement was the Isle of Man; the place in which the payment was actually made was the Isle of Man; the jurisdiction in which judgment could be obtained was the Isle of Man; the loan was unsecured and the payment of interest was made by Mr Perrin from funds in the Isle of Man.

The Upper Tribunal said that residence is one factor and there are other factors to be taken into account. However, having taken all those other factors into account, the Upper Tribunal concluded that the source is where the debtor is resident. They said that the proper law, the jurisdiction of enforcement, the place of payment are of little or no weight. If all the other factors which have to be taken into account have little or no weight, one might conclude that they do not really have to be taken into account at all. This pretty much only leaves the residence of the debtor to be the single conclusive factor.

I noticed an interesting passage in the judgment relating to specialty debts. The Upper Tribunal referred to the distinction between the situs of a simple debt and the situs of a speciality debt. They seem clearly to acknowledge that different rules apply to each type of debt and the traditional distinction has been that a speciality debt is regarded as situated where the instrument is physically located. This is no longer relevant for income tax purposes because Section 874(6A) ITA 2007 makes the situs of a speciality debt irrelevant for income tax purposes. However, it would seem to follow that the old rules still apply for inheritance tax – in contrast to the view taken by HMRC since 24 January 2013 when they announced that both simple debts and speciality debts should both be regarded as situated where the debtor is resident.

I think we have some way to go before these things are clarified.

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