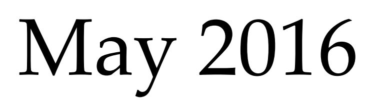

FIELD COURT TAX CHAMBERS

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Latest Rates of Inflation and Interest

The following are the current rates at May 2016

Current Rates	
Retail Price Index: April 2016	261.4
Inflation Rate: April 2016	1.3%
Indexation factor from March 1982:	
to March 2016	2.287
to April 2016	2.290

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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Entrepreneurs' Relief

The recent case of *Mr and Mrs McQuillan v HMRC* TC 5074 gives rise to a most interesting issue. (Actually, if anybody else finds this interesting, they should buy an anorak and come on holiday with me).

The taxpayers each held 33 ordinary shares of £1 each in a trading company. Other shareholders had 30,000 non-voting shares which had no rights to dividends.

The question was whether these 30,000 non-voting shares were "ordinary shares" for the purposes of entrepreneurs' relief because if they were, the taxpayers obviously did not have the necessary 5% of the ordinary share capital enabling them to qualify for the relief.

Section 989 Income Tax Act 2007 provides the definition of ordinary share capital as follows:

> "all the company's issued share capital (however described) other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits".

The tribunal had to decide whether shares which had no right to any dividend was the same as having a right to a dividend at a fixed rate – that is to say zero.

A matter which engages a great deal of academic attention is whether zero is a number – or whether it is the absence of a number. Regrettably, we do not need to get into that – nor the even more interesting question of whether zero divided by zero is infinity, zero, or unity. Life as a tax lawyer is just so much fun.

Anyway moving on. The taxpayer said that the non-voting shares had the right to a dividend of 0% which was a dividend at a fixed rate and therefore those shares should be excluded from the class of ordinary share capital.

HMRC argued that the shares simply had no rights to dividend. They did not have a right to a dividend at a fixed rate – they did not have a right to a dividend at all – and should therefore not be excluded from the definition of ordinary share capital.

It is on such distinctions that very substantial tax liabilities arise.

If the shares had been issued with the specific term that the shareholders shall be entitled to a dividend at the rate of 0%, one can see the argument that this could be described as having a right to a dividend at a fixed rate. However, where the shares simply have no dividend rights at all, the answer would seem to be different. It is difficult to see how the absence of a right should be equivalent to a right at 0%. For example, if I buy a car, the purchase would obviously not give me the right to a refund of my TV licence fee. However, it would hardly be appropriate to say that my purchase of the car gives me "a right to TV licence fee refund at a rate of 0%".

Perhaps more relevant in terms of tax, there is a world of difference between being outside the scope of VAT and therefore having no right to charge VAT, and charging VAT at a rate of 0% (i.e. zero rating). This is a very profound difference for VAT purposes with lots of implications. Admittedly, VAT has some very special rules which complicate the argument but that would not seem to affect the general principle.

The tribunal concluded this difficult question by saying that a right to no dividend is a right to a dividend at a fixed rate for the purposes of this definition. Accordingly, these shares could be excluded from the definition of ordinary share capital and the taxpayer was entitled to entrepreneurs' relief.

Whilst this represents a triumph for common sense given the configuration of the share capital in this case – there may be a number of people who have difficulty accepting the underlying analysis.

Errors in Assessments etc

The case of *Mabbutt v HMRC* TC 5075 was concerned with a challenge by the taxpayer to an enquiry notice issued by HMRC which contained an error. It was said to be an enquiry into the year ended 6th April 2009, which obviously gave rise to a problem. HMRC acknowledged the error but claimed that the error did not affect the validity of the enquiry notice.

In this case they relied on s.114 TMA 1970 which says broadly that an assessment or other proceeding shall not be affected by reason of a mistake, defect or omission if it is in substance and effect in conformity with or according to the intent and meaning of the Taxes Acts.

The onus of proof is on HMRC to prove that a notice of enquiry is valid and where there are errors, it is also for them to prove that section 114 applies.

The tribunal said that for HMRC to rely on s.114 to cure the errors in their enquiry notice, they needed to satisfy four conditions. The enquiry notice had to be an "other proceeding"; it had to be issued pursuant to the Taxes Acts; the person charged or affected must be designated according to common intent or understanding; and finally the disputed notice must be in substance and effect in conformity with the intent or meaning of the Taxes Acts.

Although three of those conditions were met, the tribunal did not consider that the notice was in substance and effect in conformity with or according to the intent and meaning of the Taxes Acts. The error resulted in an intention to enquire into a tax return for a year which did not exist. Accordingly, they concluded that there was no valid notice of an enquiry and it could not be saved by the application of s.114.

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Mistakes

The tax effects of making a mistake continues to exercise the courts.

The decision of the Supreme Court in *Pitt v Holt* (2013) was pretty much the last word on mistake and on the limits of the Hastings Bass principle.

However, the courts continue to have a good deal of sympathy for people who have done things which end up having enormously serious tax implications which they did not anticipate.

Last year, the case of *Wright v Nat West Bank Plc* followed the guidance from the Supreme Court that such a mistake cannot be a pure question of fact nor can it have arisen simply out of inadvertence or ignorance. Furthermore, the causative mistake must be so grave that it would be unconscionable for the court to refuse relief.

This principle was followed by *Freedman v Freedman* (2015) and more recently in *Bainbridge v Bainbridge* (2016) EWHC 898 where the court found that a transfer to a trust could be rescinded because it had given rise to disastrous and unexpected tax consequences.

The taxpayers transferred several pieces of farmland to a discretionary trust which gave rise to a substantial and unexpected capital gains tax liability. The trustees subsequently sold part of the land. They sought relief by way of rescission of the transfer on the grounds of mistake. The court felt the mistake (or the consequences) were sufficiently grave that they allowed relief – and furthermore, assisted them in still further relief.

The court said that once the transfers into the trust were rescinded, they were treated as never having happened so the subsequent sale by the trustees should be treated as being a sale by the original owners. As luck would have it, because the original owners had purchased some new land for the purposes of their trade, this meant that they were entitled to rollover relief in respect of the gain.

It is too early to tell whether a new and sympathetic principle is being established, but these are obviously extremely helpful developments because adverse tax consequences can arise so easily. However, rescission is an equitable remedy at the discretion of the court so the case needs to be sufficiently compelling to tweak the judicial heart strings – which may sometimes be hard to find. However, there would seem to be an opportunity (or at least a hope) that the courts may come to the rescue if tax disaster strikes.

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Careless Conduct

The case of *Anderson v HMRC* provided a helpful review of what represents carelessness in the context of a person's tax affairs – which really means whether he had failed to take reasonable care.

The issue was whether HMRC could raise a discovery assessment because (in this case) they needed to show that the taxpayer had been careless. The relevant test is what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of his tax return would have done. Furthermore, it is now well established that a taxpayer who takes appropriate professional advice with a view to ensuring that his tax return is correct and acts in accordance with that advice (providing it is not obviously wrong) will not be negligent. For reasons which are explained below, the tribunal concluded that Mr Anderson taxpayer had not been careless.

Mr Anderson had transferred some shares and computed the capital gain for the purpose of his tax return using a value of £72 million. This was the price at which there was an extant offer from an independent third party and which was likely to be accepted by the shareholders. They also relied on the advice of PwC who confirmed that in their opinion the market value the shares was £72 million.

Two years later the shares were sold for a higher figure and HMRC sought to challenge the £72 million value placed on the shares and to charge tax on a higher value on the grounds that the taxpayer had been careless in using the £72 million figure.

Leaving aside the obvious issue surrounding the prohibited use of hindsight, the stance taken by HMRC was to say that the taxpayer acted unreasonably in basing their conclusion on the existence of a bid from a single party and that they should have obtained a professional valuation.

"Excuse me" said the taxpayer. "We not only had a bona fide bid for the shares from an unconnected third party for £72 million, we also took professional advice from PwC who advised us that the value was £72 million".

Er Um said HMRC. "Well, in that case, reliance on a third party cannot be a reasonable excuse."

I suppose we should welcome the vigour with which HMRC like to place every possible argument before the court.

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SDLT – Project Blue

Anybody who was alarmed by the decision of the Upper Tribunal in the case of *Project Blue Ltd v HMRC* [2014] UKUT 0564 may be comforted (a bit) by the recent judgment of the Court of Appeal who have found in favour of the taxpayers.

The issue in Project Blue was the amount of SDLT payable on the acquisition of a property where the financing had been structured to comply with Sharia law. The figures were huge and the issues were inevitably seriously complicated – but the bit catching my eye was the possible application of section 75A Finance Act 2003 which is the all encompassing anti avoidance SDLT provision. This is pretty complicated too, requiring an analysis of the transaction and the effective rewriting of the contract by assuming that it took place between other parties, with the result that a higher amount of SDLT becomes payable.

The taxpayer argued that for section 75A to apply there needs to be some intention or motive to avoid SDLT – after all, that is what an anti-avoidance provision is for and this is specifically stated in the side note to the section. However, the Upper Tribunal said that nowhere in the terms of the section is there any reference to an avoidance motive being necessary for the operation of section 75A.

The Court of Appeal held that section 75A did not apply to the transaction in Project Blue – but not for this reason. They specifically agreed with the Upper Tribunal that a tax avoidance purpose is not required for section 75A to be brought into play. They found in favour of the taxpayer on different grounds – namely that when identifying the notional transaction which is assumed by the section, it did not have the result suggested by HMRC.

Section 75A remains a serious threat whenever SDLT is in point and I do not see much real comfort coming from this decision.

Follower Notices

There has been loads written about Accelerated Payment Notices and Follower Notices – whether they are fair, valid, contrary to our human rights etc – but anybody wishing to protest by not paying up when they get a Follower Notice should take note of the HMRC statement issued on 26th May which sets out the penalty position.

If you don’t pay you will get a penalty of 50% - although it can be reduced by various factors such as being helpful to HMRC in counteracting the tax advantage you have sought.

This is seriously tough when no tax liability has even been established – but these are the rules and it is best to be aware. You can appeal of course….

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