# UK Tax Bulletin

June 2017

Field Court Tax Chambers

FIELD COURT TAX CHAMBERS

# Contents June 2017

# Latest Rates of Inflation and Interest

## The following are the current rates at May 2017

| Current Rates | |
|---|---|
| Retail Price Index: May 2017 | 271.7 |
| Inflation Rate: May 2017 | 3.7% |
| Indexation factor from March 1982: | |
| to April 2017 | 2.406 |
| to May 2017 | 2.420 |

### 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 6th April 2014: 4%

To 6th April 2015: 3.25%

To 6th April 2017: 3%

From 6th April 2017: 2.5%

# Finance Bill Update

I am afraid there is still no news – but HMRC say there will be a Summer Finance Bill soon so maybe things will become clearer. Maybe.

Sadly (very sadly) two of my clients died very recently. They would both have become deemed domiciled for all relevant purposes on 6th April 2017 under the new rules. However, they didn't – because the law did not come in on 6th April as expected. So when they died, the law was clear; they were not UK domiciled.

It is possible that the Treasury will seek to backdate these non dom rules to 6th April 2017 – which would mean that these gentlemen will be charged tax on the basis of rules which did not apply during their lifetime but were introduced after their death to make them liable to tax before they died.

Admittedly the rules are draconian but surely that is going too far. Bringing in laws after someone has died to tax them during their lifetime is surely repugnant. Indeed, where would it end. There are lots of very rich and very dead people; how far back shall we go? I think that William the Conqueror had a few bob ….

Maybe HMRC will see the sense of this and suggest a relief for people who died before Royal Assent – or possibly a right of election for taxpayers to opt into the new rules from 6 April 2017?

# Discovery Assessments

Last June I referred to a number of Tribunal cases which examined the question of whether a discovery can be "stale". This could occur where HMRC have made a discovery but take too long to raise the assessment causing it to go out of time – even if the statutory time limit has not expired. Regrettably the cases were in conflict – with one First Tier Tribunal case rejecting the whole concept – but two Upper Tribunal decisions did acknowledge the possibility, explaining that HMRC cannot:

> "sit on it and do nothing for a number of years before making an assessment just before the end of the limitation period"

The issue has recently arisen again in the case of *Clive Beagles v HMRC TC 5925* where the FTT made it quite clear that as a matter of law, a discovery can become stale.

In the case of Mr Beagles, although this principle was confirmed, the FTT decided that the discovery had not in fact "lost its newness" and become stale, so the assessment was valid. Nevertheless, it represents a useful confirmation of this aspect of the rules on discovery assessments.

## Share Valuation

The recent case of *Cosmetic Warriors Ltd v Andrew Gerrie [2017] EWCA Civ 324* had some interesting things to say about the principles for valuing unquoted shares. In this case, the dispute related to the construction of the company's Articles of Association which provided a formula for the valuation of the shares, to be used in various circumstances.

Mr Gerrie held approximately 11% of the shares in the company (and his wife had a further 10%). The majority shareholders were a Mr and Mr Constantine who between them owned 62% of the company shares.

The Articles of the company provided that in the event of a shareholder giving a notice, or ceasing to be an employee, the shares could be purchased by the company at an agreed price – failing that at the median price certified by two independent chartered accountants as being the fair value as between a willing buyer and a willing seller, valuing the company on a going concern basis.

And it came to pass that such a valuation was required and the question for determination by the court was whether the shares should be valued on the basis of a pro rata value of the whole company or whether it should be valued having regard to its status as a minority shareholding.

This was a valuation for a real purpose – compared with a valuation for tax purposes which would be constrained by an enormous number of artificial rules.

The company argued that because the shareholding in question was a minority holding, there was no reason why the Articles should be construed as putting an artificial value on the shares. This was just common sense because in a business context, parties do not usually envisage artificial exercises.

However, the Court of Appeal were unpersuaded. They took the view that because the Articles referred to the valuation being undertaken on a going concern basis, the value must be ascertained on the basis of the company as a whole being valued and that it must follow that the price per share had to be ascertained on a pro rata basis.

Some may consider that this does not necessarily follow. It might reasonably be said that the reference to a going concern basis in the Articles was merely there to distinguish it from a forced sale or break-up basis (which would invariably – and unjustifiably in the case of a continuing business – give rise to a very low value) and have nothing to do with valuing the company as a whole, or on a pro rata basis.

The Court made important references to the Articles being a statutory contract between the members and that it was necessary for the value to be a fair value. However, they specifically referred to a pro rata value being higher than the price that the shareholder could expect to obtain on the open market. It is difficult to reconcile the concept of a fair value with a price which is higher than market value; one would have thought that a fair value would be that representing the market value – not one which is higher than market value.

Anyway, this was the way in which the Court of Appeal construed the Articles.

However difficult it may be to grasp this reasoning, a clue to the process may be the Court's reference to:

> "a private company with few members where the relationship between the key shareholders may well be one of quasi-partnership".

It is well established that where a business is being carried on by a company which is a quasi-partnership, with all the shareholders participating fully in the management and risks of the business, a pro rata valuation of all the shares will be appropriate. Accordingly, this may be the key to the decision – although there seems little in the judgment to indicate that a quasi-partnership in fact existed. (Indeed, a group with more than 900 outlets in 49 countries would not immediately be thought of as a quasi-partnership.)

However, this case would seem to be useful additional authority for the valuation on a quasi-partnership basis where a high value for shares is desired.

Another reason why a minority discount might not apply is because Mr and Mrs Constantine owned 62% of the shares. Although this point was not mentioned in the judgment, it would be possible to argue that Mr and Mrs Constantine might reasonably be prepared to pay a premium for these shares because it would enhance their majority shareholding. Mr and Mrs Constantine would be special purchasers and the existence of a special purchaser is well-known as a reason for a higher value to be placed on a particular holding of shares. It is not that Mr and Mrs Constantine could be assumed to be the purchasers. We cannot assume a particular purchaser – but they would form part of the market. The point is that the market would be aware of their existence and that the shares would be particularly value to them.

Accordingly, any purchaser would know that they may be able to sell their shares to Mr and Mrs Constantine for a higher value than the ordinarily discounted value of a small minority holding; this would naturally drive up the price. (However, be that as it may, it would not still end up as a pro rata value because even Mr and Mrs Constantine would not pay pro rata for such a holding).

Coincidentally another FTT case was published this month on the valuation of unquoted shares – although in the case of *Netley v HMRC TC 5904*, the Tribunal was not concerned with a "real" valuation but with a valuation for tax purposes. The case was long and complicated but contained some helpful guidance on the relevance of quoted indices to a valuation of unquoted shares, and a lengthy analysis of the information standard – that is to say, the information which a hypothetical purchaser, being a prudent man of business, would require before he could come to a conclusion about the price he would be prepared to pay.

This is a controversial area as it includes a consideration of whether information which is not available (and could not in reality be made available) to a prospective purchaser, can be taken into account in the valuation.

The expert witnesses for both the taxpayer and HMRC agreed that the default position is that information relating to future prospects cannot be regarded as available – and the Tribunal analysed the extent to which any deviation can be made from this default position. The result was rather fact specific to the particular case, but it may still be of interest to those concerned with such arguments – if only to see the approach taken by HMRC.

## Penalties

Having regard to the enormous volume of penalties cases which appear before the Tribunals – most of the cases listed are penalty cases – it is no surprise that every now and again something interesting pops up. The case of *Pidgeon v HMRC TC 5900* is one of those cases.

It is worth repeating that if the majority of tribunal cases involve penalties (which must be the tip of the iceberg because nobody takes a penalty to the tribunal lightly) there is something not quite right with the system. If people keep accidentally going through the wrong door, or having a road accident at exactly the same place, it says more about the design of the building or the road than it does about the culpability of the victim.

Mr Pidgeon submitted his tax return but HMRC took the view that the return was not sufficient for their purposes and decided to treat it as though it had not been filed.

HMRC chose not to inform Mr Pidgeon that they had taken this view but simply clocked up penalties which they eventually communicated to Mr Pidgeon. It is no surprise that Mr Pidgeon complained and the matter came before the Tribunal.

The Tribunal said that whether the tax return was a tax return within the meaning of section 8 TMA 1970 was a matter of fact and degree. (Unfortunately, they did not explain this further so we do not know quite what this means – but we can get the general idea).

The Tribunal went on to say that it is not open to HMRC simply to reject a return on the grounds that there may be some detail lacking – unless the omissions are, as a matter of fact and degree, so serious as to allow it to be said that a return is not in reality a return under section 8.

Furthermore, the Tribunal drew attention to the obligation on HMRC to prove that a penalty was due. In this case, they had to prove that Mr Pidgeon did not submit a tax return which could properly be described as such. It was simply not enough for them to say that a satisfactory return was not submitted – assertions are not enough. They have to prove their case.

Contrary to the view of HMRC, the mere fact that they rejected the return is not a sufficient reason for the Tribunal to conclude that it did not meet the statutory requirements.

Under the circumstances it is no surprise that the penalty was quashed and Mr Pidgeon's appeal succeeded. It would be extremely unsatisfactory for HMRC to succeed in a suggestion that they came reject somebody's return and cause penalties to arise without even telling them - or telling them what (in their view) was wrong with the return in the first place.

Fortunately, the Tribunal said that HMRC were wrong to act in this way – but it would still be nice to know under what circumstances HMRC are entitled to reject a return on these grounds. It is one thing for the return to contain omissions – there are provisions for that - but I wonder what you have to do to enable HMRC to reject your return completely.

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