UK Tax Bulletin

April 2018

Field Court Tax Chambers

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April 2018

Latest Rates of Inflation and Interest

The following are the current rates at March 2018

Current Rates	
Retail Price Index: March 2018	278.3
Inflation Rate: March 2018	3.3%
Indexation factor from March 1982: Frozen at December 2017	2.501

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% from 21st November 2017

There is one exception: Quarterly instalments of corporation tax bear interest at only 1.25% - but this was increased to 1.50% from 13th November 2017

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%

Residence – Old Style

I have been reading the case of James Glyn v HMRC TC 6452 which was concerned with the rules relating to residence before the introduction of the Statutory Residence Test. It could be significant.

It may be remembered that Mr Glyn left the UK and took up residence in Monaco in 2005 and the FTT agreed that he had become non resident. The Upper Tribunal said that the FTT had not looked at some aspects in the right way and remitted the case to the FTT for rehearing – on the same facts, with no new evidence. A differently constituted FTT has now decided that Mr Glyn did not lose his UK residence because they considered that his ties with the UK were not so substantially loosened that he had made a distinct break with the UK.

This is a curious formulation because the test is not "making a distinct break with the UK" but making "a distinct break in the pattern of his life in the UK" which is the test established by the Supreme Court in Gaines Cooper in 2011. This looks like a difference of substance, but maybe it was just shorthand.

I will not dwell on all the detailed facts here but after reading the 76 pages of this case, some people might consider that, if Mr Glyn did not substantially loosen his ties, it is difficult to see in what circumstances this test could be satisfied. (Maybe Nietzsche was right: "*There are no facts – just interpretations*").

I must say it has caused me to revisit my view of the Statutory Residence Test. I have long thought that the vagueness inherent in some of the SRT tests meant that it achieved very little - merely substituting a whole lot of new uncertainties for the old uncertainties. However for those who support the view that it is a good thing for the law to be certain – it being a fundamental principle of a civilised society that citizens are able to regulate their conduct to be in accordance with the law (and therefore need to have a reasonable chance of understanding what the law is) - then I think they are probably better off with the Statutory Residence Test.

Discovery Assessments

The arguments and appeal hearings about discovery assessments continue unabated, and the subject gets ever more confused as the meaning of these rules is continually refined. The angels who are dancing on section 29 TMA 1970 are having a ball. The resources which are consumed in arguments on this subject do not bear thinking about.

The recent case of <u>*Blum v HMRC TC 6404*</u> provides some additional and important assistance in the proper interpretation of the legislation.

It is well known that section 29(5) provides that HMRC cannot raise a discovery assessment outside the time limit unless

> *"the officer could not have been reasonably expected, on the basis of the information available to him before that time, to be aware of [the insufficiency]"*

Section 29(6) provides that the information available to the officer for this purpose is confined to information provided by the taxpayer. This is a trap. The taxpayer may know full well that HMRC have been provided with all the relevant information and documents (maybe a number of times) but unless he sends them the information (again) himself, it will be disregarded. (Not wishing to get distracted here, I wonder who he sends the information to. We are looking at the information available to the hypothetical tax officer – so how does he provide the information to him?).

Anyway, moving on, the Tribunal said that this was not right. Section 29(6)(d)(i) allows information that could reasonably be expected to be inferred from the information supplied by the taxpayer, can be treated as having been made available to the hypothetical officer.

You might say this is blindingly obvious. Section 29(6)(d)(i) has always been there and we all knew this - so why am I making a big deal about it. Er, well HMRC didn't know. They argued that because Mrs Blum did not provide the information personally, it should be ignored for section 29(5) purposes.

Another interesting aspect of this case was that because Mrs Blum was not in business, section 12B TMA 1970 requires her to keep records until the first anniversary of the 31st January next following the year of assessment. Mrs Blum said it was unreasonable that HMRC could raise an assessment within 4 years, by which time she may, quite properly, have no records to dispute the assessment.

The judge acknowledged the difficulty, but said that this was the law and there was nothing he could do.

Cor. This is seriously unfair and let's hope that something is done about it before too long.

Quasi Partnerships

The recent case of Wootliff v Rushton-Turner [2016] EWHC 2802 considered the issue of quasi-partnerships. This was not a tax case, but the existence of a quasi-partnerships can be crucial in a tax context when one is wishing to value shares in a private company – because it is the value of shares which is often the determinant of a liability to income tax, and sometimes to capital gains tax, where there is a disposal requiring market value to be taken as the disposal value.

Where there is a minority holding in a private company, the value of the shares is likely to be discounted to take into account not only the normal impediments such as unmarketability, but also the lack of control or other influence which is an inevitable feature of a minority holding. The smaller the holding, the greater the minority discount. It is comparatively unusual (except where there is express contractual requirement) for a minority holding to be valued on the basis of a pro rata value of the whole company.

In the case of a partnership interest, there is no similar concept of a minority holding and the value of a partnership interest is likely to be undertaken by reference to a pro rata value of the whole partnership.

So, if a private company can be regarded as a quasi-partnership, this would eliminate the minority discount when valuing the shares. This is likely to result in a much higher value being brought into charge to tax – for capital gains tax on a disposal or maybe income tax on a share award.

Sometimes however a high value is required, for example where rebasing applies, or on a disposal by a non-resident before he becomes resident in the UK. In such cases the existence of a quasi-partnership argument might be extremely helpful.

There are numerous authorities on quasi-partnerships, one of the more celebrated being *Ebrahimi v Westbourne Galleries Ltd [1973] AC 360* which explains that it can apply where there are personal relationships between the shareholders, a degree of mutual trust and an understanding of participation in management with the provision of capital beyond pure equity. Similar issues arose in *Buckingham v Francis* and in *Re a Company 003420/1987.* Each of these cases concerned minority oppression or unfair prejudice for Companies Act purposes.

In *Re a Company* it was highlighted that in the case of a small private company, two or three members may have invested their capital by subscribing for shares on the footing that dividends are unlikely but that each will earn his living by working for the company; and the case of *Phoenix Contracts (Leicester) Ltd [2010] EWHC 2375* suggested that the role as a director and shareholder could not be separated.

In *Wootliff*, the court suggested that it would largely depend upon the relationship between the members of the company, with the unfairness being judged by testing whether the majority has acted, or is proposing to act, in a manner contrary to good faith.

The court found that the relationships between the parties in *Wootliff* were not personal enough, nor were the other considerations sufficient to make the company a quasi-partnership, but the underlying principles were confirmed.

Source of Income

The case of *Ashraf v HMRC TC 6355* has a historical significance in reinforcing the ancient rule that for income to be taxable, it must have a *source*. The case involved a COP9 investigation which revealed substantial deficits in Mr Ashraf's resources, that is to say between his income and his expenditure – like £70,000. Such a discrepancy will always be something which calls for an explanation. HMRC naturally claimed that this unexplained £70,000 represented money which should have been brought into charge to tax.

Although Mr Ashraf was unable to explain the reason for this large discrepancy, the problem was that HMRC did not advance any argument regarding the source of the money. They merely brought the deficit into charge to income tax – but without saying where it came from or its source. The case therefore centred on the requirement that every receipt of income must have a source - but HMRC had not been able to identify an income source, they merely allocated it to other income in the self-assessment calculations.

The burden of proof was on HMRC to show that there was a source of income which had been omitted, and in the absence of any evidence regarding the source, an assessment to tax could not be validly made.

IHT: DOTAS

On 1st April 2018 new DOTAS regulations for IHT came into force, and everything now has to be tested against a new hallmark – in addition to the old confidentiality and premium fee hallmarks.

An arrangement is notifiable under the new regulations if an IHT advantage is expected to be a main benefit and if it is reasonable to expect an informed observer to conclude that it satisfies two conditions. (An informed observer is someone who is not an expert but has all the relevant information and has the knowledge and skill to understand the arrangements in the statutory context).

The first condition is that the main purpose of the arrangement is to obtain an inheritance tax advantage such as the avoidance (or reduction) of:

- An entry charge to a trust;
- A ten year or exit charge;
- The gift with reservation rules;
- A reduction in a person's estate without a PET or chargeable transfer.

It is difficult to imagine any inheritance tax planning which does not fall within one of these, so everything will depend upon condition 2.

The second condition applies where the arrangements involve one or more contrived or abnormal steps.

HMRC say that normal and straightforward IHT planning will not be notifiable – but that is impossibly subjective. What is normal for one person will be abnormal to another, and to make it the judgment of an informed observer makes it even more difficult. The Courts and Tribunals will not have a consistent view and the whole thing will be clouded in uncertainty for years. Equally unsatisfactorily, there will be loads and loads of arguments about this – adding unnecessarily to the pressure on the Courts and Tribunals.

HMRC have prepared a guidance note on these new rules which includes various examples of arrangements that they consider not to be contrived or abnormal, such as a transfer to a spouse utilising the spouse exemption, or making regular gifts out of income, potentially exempt transfers or transfers within the nil rate band. They say that these are not abnormal because they just take advantage of a statutory relief or exemption.

Unfortunately, one of their examples rather gives the game away. There is a specific relief in section 102B(4) FA 1986 to exclude the reservation of benefits rules to a gift of an undivided share in land which is occupied by the donor and the donee. HMRC say this is not abnormal because it is in accordance with the legislation but they will take a different view if the donor retains only a very small proportion of the property. This is not a condition which appears in the legislation – from which one may properly conclude that it was not intended by Parliament.

So HMRC will not really regard the use of an exemption provided by the legislation as any protection for the taxpayer. If they fancy it, they will just add a new condition of their own which is not in the legislation and say you do not satisfy it. If this were not so serious, it would be amusing.

However, it would not be right to complain too much about all this because these guidance notes are only HMRC's view of these new regulations – and the purpose of the regulations is only to provide information for HMRC. It does not change any of the IHT rules. It is not unreasonable for HMRC to seek information about areas of potential sensitivity so that they may have the opportunity to consider them fully.

Costs

It is not very often that the taxpayer gets awarded costs at the First Tier Tribunal so the case of *Cannon v HMRC TC 6413* is worthy of some attention.

Unless the case is assigned to the Complex Track, costs are not awarded at the FTT unless one of the parties has acted unreasonably in bringing, defending or conducting the proceedings: *Rule 10 Tribunal Procedure (First Tier Tribunal) (Tax Chamber) Rules 2009.*

The Tribunal held that HMRC had acted unreasonably in this case. They had rather a lot to say, but I particularly noticed one interesting passage. The judge said that HMRC had taken an entrenched position and were:

> *"deaf to any kind of explanations and/or arguments that could properly be advanced by the taxpayer".*

This is an interesting phrase - which might strike a chord with some people.

However, that is not enough to give rise to an entitlement to costs. The unreasonable conduct must have been causative of costs being incurred which would not otherwise have arisen. That is by no means the same thing but there is clearly scope for proper recompense on these grounds.

However, it is important to recognise that although this was a case where the taxpayer claimed costs because he considered HMRC had acted unreasonably - it can work the other way round too.

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