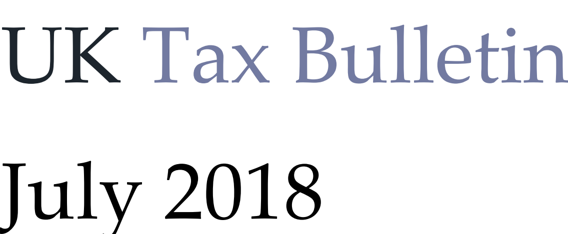
UK Tax Bulletin
July 2018

Field Court Tax Chambers

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Latest Rates of Inflation and Interest

The following are the current rates for July 2018

Current Rates	
Retail Price Index: June 2018	281.5
Inflation Rate: June 2018	3.4%
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%

Tax Avoidance Motive Test

Occasionally tax advisors are faced with a conundrum in connection with the various tax motive tests, that if a taxpayer claims a tax relief, he must have done so for the purpose of obtaining a tax advantage – so he is therefore disqualified from the relief by reason of his tax avoidance motive.

The most obvious example is investing in shares qualifying for EIS. Of course you want the tax relief – the whole purpose of the EIS is to encourage investment by the provision of a tax advantage and it is bound to be one of the purposes of making the investment (and so easy for HMRC to say that it is one of the main purposes). but by doing so, you are disqualified because of one of the main purposes would be the avoidance of tax. You fall squarely into section 178 Income Tax Act 2007.

This has generally been regarded as merely an amusement reminiscent of Albert Haddock, because it would be ridiculous to enact a relief which is denied by the very act of claiming it. Time to stop laughing now. This is exactly the argument advanced by HMRC in the case of *Oxbotica Ltd v HMRC TC 6538*.

The case involved a spin out from Oxford University of some innovative products which had been developed and patented by a number of professors who were the investors in the company. The facts reported in the case reveal a wholly conventional spin out, with no special or abusive features. The investors did however claim Seed EIS relief (shock horror).

HMRC argued that the purpose of the investors was to secure tax relief under the SEIS rules; they therefore failed the motive test and they were disqualified from relief.

You can just see Macbeth opening his post in the morning:

> "Is this a tax relief which I see before me,
>
> the share certificate toward my hand? Come, let me clutch thee.
>
> I have thee not, and yet I see thee still.
>
> Art thou not, fatal vision, sensible to feeling as to sight? Or art thou but a tax relief of the mind, a false creation …
>
> Thou marshall'st me the way that I was going and such an instrument I was to use.
> Mine eyes are made the fools of the other senses"

This argument by HMRC was roundly rejected by the Tribunal.

HMRC had some more arguments. Section 257CB Income Tax Act 2007 provides that the shares must be issued to raise money for the purpose of a qualifying business activity carried on by the company. HMRC argued that the share subscription monies were not used for the business because the amounts were too small to be "of meaningful use" as the company had secured funding from the university for their project.

The Tribunal rejected all the arguments of HMRC saying that: "*Their focus was again and again and again on the articulation [of] their own guidance*". The Tribunal held that HMRC were wrong to seek to impose a minimum level of investment when Parliament had not done so; there was no basis for suggesting there must be a meaningful level of investment (which in any event would create impossible uncertainty); and that it was not open for HMRC to contend that the tax motivation test was met.

If HMRC don't want to give EIS relief or SEIS relief, it would be better if they just abolished them rather than to pretend they exist and then deny relief when they are claimed.

IHT Business Property Relief

The Tribunals have consistently held that letting property is an investment business, no matter how extensive the services which are provided. Business property relief cannot therefore apply because section 105(3) IHTA 1984 excludes entitlement to the relief if the business:

> *"consists wholly or mainly of one or more of the following, that is to say, dealing in securities, stocks or shares, land or buildings or making or holding investments."*

The recent case of *Executors of Marjorie Ross v HMRC TC 5959* involved holiday cottages which were let, and where loads of services were provided to the guests. The Tribunal acknowledged that a high level of services was provided to guests and these services were more extensive that those considered in any previous case. However, that was irrelevant because in the view of the Tribunal, the relief would not be available "however high the standard of services which were provided and whatever the level of expenditure incurred on those services". The fact that the

business was run on sound business lines and with considerable effort, was also irrelevant. This decision, together with the cases of *Pawson v HMRC [2013] UKUT 50* and *Zetland v HMRC TC 5387* and many others, looked like the end of the road with this argument. Well, maybe not.

HMRC took the same view with regard to a livery business (which of course necessarily involves the use of land and buildings – or at least structures) saying that the business was nothing more than the letting or licensing of land for the use of others and was therefore an investment business – being the making or holding of investments: *Executors of M Vignes v HMRC TC 6068*.

However, the FTT concluded that no properly informed observer could have concluded that the livery business was wholly or mainly a business of holding investments. They said that the Upper Tribunal in *Pawson* had wrongly started from the pre-conceived idea that the business was wholly or mainly one of making or holding investments and then asked whether there were factors indicating to the contrary. The Tribunal said that the proper starting point is to make no assumption one way or the other, but to establish the facts and determine whether or not the business is wholly or mainly one of making or holding investments.

This approach has now been supported by the case of *Executors of Joyce Graham Deceased v HMRC TC 6536* which also involved the letting of holiday accommodation and the provision of various services. The taxpayer represented herself and her impressive advocacy persuaded the Tribunal that the services she provided were of such importance that the business should not be regarded as wholly or mainly an investment business. The Tribunal said that the provision of "the pool, the sauna, the bikes and in particular the personal care lavished upon guests by Louise Graham" distinguished it from a second home let out in the holidays.

It does not seem that the services provided in this case differed very much from those in *Marjorie Ross*, (or *Pawson* or *Zetland)*, all of whom were unsuccessful in their claims for business property relief, so Louise Graham's success is even more impressive.

The conclusion must be that letting property can represent a business qualifying for business property relief, being more than the mere holding of an investment – and that the nature and quality of the services provided is what makes the difference. After all that is why a hotel qualifies for relief. There is clearly a line – the Tribunals refer to it – but we do not yet know where the line is. Maybe it will become visible in due course.

Discovery Assessments

I have made occasional reference to the possibility that a discovery can become "stale". This occurs where HMRC make a discovery but take too long to raise an assessment causing it to go out of time – even if the statutory time limit has not expired. The Upper Tribunal has pretty much now concluded that this is a real possibility, explaining in *Pattullo v HMRC [2016] UKUT 0270* that HMRC cannot just:

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

HMRC must act expeditiously and the assessment must be issued whilst a discovery is "new".

So far, the Tribunals have only recognised that this *could* be the case – they have not actually found that the discoveries were stale in any particular case. However, we now have a case where the discovery assessment was invalidated on that basis.

In *Gordon v HMRC TC6537*, the Tribunal found that the discoveries were stale and that a delay of two years was too long for the discovery to retain its "essential newness" being one of the key conditions imposed by the Upper Tribunal in *Charlton v HMRC 2013 STC 866.*

Special Circumstances

The recent case of *Harrop v HMRC TC 6511* will raise a few eyebrows. This case dealt with meaning of special circumstances, the existence of which can cause a penalty to be reduced (possibly to nil) on the authority of Schedule 55 (16) FA 2009.

The reduction of penalties by reason of special circumstances has attracted the attention of the Tribunals many times and they have frequently displayed a welcome degree of sympathy to the taxpayer. A reasonable conclusion may be drawn from the various cases that "special" means unusual or uncommon. This seems also to be the view of HMRC in their Manuals, although they add that special circumstances are also "*where the strict application of the penalty law produces a result that is contrary to the clear compliance intention of that penalty law*".

Obviously, there are many different circumstances which can be regarded as special. In one recent case – Mohammed v HMRC TC 6589, the Tribunal held that multiple errors made by HMRC which mislead the taxpayer was a special circumstance entitling the taxpayer to a reduction of the penalty to nil.

However, then we come to the case of *Harrop*. In this case the Tribunal referred to the normal and generally accepted meaning of special circumstances as circumstances which are unusual or uncommon – but the judge went on to say that she could only allow the appeal if HMRC's decision "*was flawed in a judicial review sense, that is to say …the result is so outrageous that no reasonable decision maker could have reached it*".

This is completely different from anything we have seen before in connection with special circumstances. This is a Judicial Review test, which is not a test which many will feel appropriate to the statutory special circumstances reduction provided by Schedule 55(16) FA 2009.

The Tribunal went on to say that there were no special circumstances because "other taxpayers have found themselves in the same predicament and for the same reasons." Is that really a reason for there not being special circumstances? Or is it a reason to say that the same special circumstances may apply to the other taxpayers as well (particularly when the Tribunals have often found that they do)?

It will be interesting to see whether this impossibly harsh interpretation of special circumstances will be followed.

Requirement to Correct

I have previously referred to the awesome penalties under the Required to Correct Regime which will apply to anybody who fails to disclose (or notify the existence of) an offshore related liability by 30 September 2018.

HMRC has caused a few waves recently by sending out lengthy letters in bulk which are seriously aggressive.

These have caused considerable anxiety. None of the letters makes any reference to the possibility of a reasonable excuse or indeed indicating that the taxpayer has any defence at all if something can be found to be wrong with their tax returns over the last 20 years. With penalties of 250% and other associated nastiness, anybody would be a bit anxious.

The professional bodies would seem to be on the case. For example the Institute of Chartered Accountants have published a note which says that "we have a number of issues with these letters and have communicated our concerns to HMRC." I do hope this is a diplomatic understatement.

They go on to say that the three pages of requests for information which accompany these letters go beyond HMRC's legislative powers and furthermore do not follow their own guidance notes.

There will be more details published on this soon following the meetings which are shortly to take place on the subject.

CGT: Commercial Property

The draft clauses for the next Finance Bill have now been published and as expected, they include a reference to the extension of Capital Gains Tax with effect from April 2019, to UK commercial property held by non residents.

This will differ from the existing rules relating to the NRCGT charge on UK residential property because it will also apply to indirect disposals of interests in property holding vehicles such as companies, partnerships and trusts where the shareholding or similar interest exceeds 25%.

Otherwise the general idea is familiar – that capital gains on commercial property will be chargeable to capital gains tax when disposed by a non-resident, although the chargeable gain will be limited to the increase in value from April 2019.

The normal interaction with section 13 TCGA 1992 continues where the shares in the non resident company are held by a UK resident – with the effect that the company will be liable to tax on the gain from April 2019 but the UK resident shareholder (who holds more than 25% of the shares) will be chargeable to capital gains tax on his proportion the gain up to that date.

Quite apart from all that, there is a possibility of a double charge to capital gains tax on the non resident - once on a disposal of the shares and another on the disposal of the property. There is no indication (yet) how they intend to deal with this possible anomaly.

Deemed Domicile Rules

A series of guides have been published jointly by STEP, the ICAEW, the CIOT and the Law Society on four aspects of the new rules: Re-Basing, Cleansing, Trust Protections and IHT on UK residential property.

These guides set out numerous questions and provide suggested answers – but the suggested answers are not (yet) confirmed by HMRC. It will be interesting to see if there is any variation in these suggested answers when HMRC confirm their views in due course.

The cleansing provisions are widely welcomed as a means to deal with the complications of mixed funds – but 67 pages of guidance indicate just how difficult these provisions can be. (No – I don't know why they have to be so complicated either).

For anybody involved in this area, these guides make very interesting reading. I defy anybody, however familiar they are with the provisions, not to find something in these notes which they did not know – or at least something which gives them serious food for thought.

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