UK Tax Bulletin

September 2018

FIELD COURT TAX CHAMBERS

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Latest Rates of Inflation and Interest

The following are the current rates at September 2018

Current Rates	
Retail Price Index: July 2018	281.7
August 2018	284.2
Inflation Rate: July 2018	3.2%
August 2018	3.5%
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 3.25% from 21st August 2018

There is one exception: Quarterly instalments of corporation tax bear interest at only 1.75% from 13th August 2018

Repayment supplement

Interest on overpaid tax is payable at the same rate from 21st August 2018

The formula is Bank base rate minus 1% but with an overriding minimum of 0.5% which applies at the present time.

Except IHT where the rate is 0.75%

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%

Duality of Purpose

The wholly and exclusively rule and the concept of duality of purpose has dogged tax advisers and their clients for generations. Businessmen find it completely incomprehensible (they have another word for it) that expenditure which is obviously incurred entirely for business purposes – like the cost of travelling to work – is not deductible from their profits for tax purposes. We of course know better. We know that such expenditure is not for business purposes because it "*is not to enable a man to do his work but to live away from it*." (Newsom v Robertson 33 TC 452)

Money spent on work clothing is another example. The current formulation of the rule is found in section 34 ITTOIA 2005 rule, that the expenditure must be incurred "*wholly and exclusively for the purposes of the trade*". The House of Lords ruled in *Mallalieu v Drummond 57 TC 330* that where a taxpayer purchased clothing which is required for doing her job, it was not enough for the expenditure to be wholly and exclusively for the purposes of her trade (or profession). One may wonder why not, if she satisfied precisely the requirements of the section.

This is because it was also necessary to consider her subconscious purpose – which in the case of Miss Mallalieu, was not only to ensure that she was properly dressed for appearing in court (and without which she would not have been heard) but also to satisfy the requirements of warmth and decency. On these grounds she was not entitled to any deduction for the expenditure.

We know that this is right because the House of Lords said so – and that is the law – but it makes a deduction for any business expenditure very difficult. Just as tax advisers can often find a business purpose for almost any item of expenditure if they try hard enough – so can HMRC find a subconscious non-business motive if they put their mind to it.

With this background, it is interesting to read the First Tier Tribunal decision in *Gemma Daniels TC6640*. Miss Daniels was a self-employed dancer at Stringfellows. She made a claim to deduct the cost of her work clothes. Seeing as how she danced without any clothes on at all (although the judgment does indicate that she kept her shoes on), she obviously had no subconscious purpose of warmth and decency. It is not at all clear what part of her work she needed the clothes for, if it was not to wear when she was dancing, even though the Tribunal judge referred to the clothes as being "alluring". Best not go there.

There are extracts from both judgments which are (surprisingly) interchangeable and one might have thought that Miss Daniels had little chance with her claim in the face of such powerful authority. However, the Tribunal felt able to distinguish *Mallalieu v Drummond* and allowed Miss Daniels a deduction for the cost of her clothing.

This gives rise to the odd comparison with Miss Mallalieu who would not have been permitted to do her job in court if she did not have the right clothes – but Miss Daniels would not have been allowed to do her job on the dance floor if she was wearing any clothes. (To anybody unversed in tax matters these decisions might seem to be the wrong way round).

Mallalieu v Drummond was decided in 1983 and an interesting feature of the decision of the Special Commissioners is that it started with the following sentence: *"Miss Mallalieu is an attractive blond barrister"* which was presumably a finding of fact rather than law. Although it was undoubtedly true, there would be very serious consequences if a judge made such a statement now. The world has moved on - and so perhaps should the reasoning in *Mallalieu v Drummond.* Maybe the decision in *Gemma Daniels* is a first step in that direction.

I think that the inevitable appeal will be interesting.

CGT Hold Over Relief

Last year I made reference to the First Tier Tribunal decision in *Reeves v HMRC* *TC 5680* in which the Tribunal was concerned with a claim for capital gains tax holdover relief. In particular they were considering section 167 TCGA 1992 which denies holdover relief if the transferee is a company which is controlled by non-residents.

Mr Reeves made a gift of an asset to a UK company and claimed holdover relief.

That was fine – because Mr Reeves owned all the shares in the company and he was UK resident. However, he was married and his wife was non-resident. One might wonder what that has got to do with it because she had nothing to do with the company. Unfortunately, because husbands and wives are connected persons, his shareholding could be attributable to her for the purposes of control in section 167. So she was non-resident, his shareholding could be attributable to her and therefore the company was controlled by a non-resident. No relief.

Exactly the same position would have occurred if Mr and Mrs Reeves were both UK resident, but one of their children happened to be at university (or on a gap year) abroad. The child would be non-resident, and as they would be connected with Mr Reeves, this would disqualify his holdover relief claim. Bonkers is a word that springs to mind.

This absurdity could not possibly have been what Parliament intended – and one might have thought that the FTT could have taken on board the reasoning of the Supreme Court in the cases of UBS and DB. The Supreme Court said that if the construction makes no sense and could not be what Parliament intended, a purposive construction should be available to assist the taxpayer – or more precisely, an appropriate purposive construction could be adopted to interpret legislation in the light of the transaction which took place.

The Upper Tribunal have now considered this matter and, not without difficulty, found a solution. They acknowledged that this result could not have been the intention of Parliament and some modification was required to the definition of control – but they struggled to find an appropriate modification.

They concluded that the restriction to the hold over relief rules in section 167(2) should be interpreted as being confined to connected persons who have an interest in the company. This is consistent with the definition of control in section 96(10) TCGA 1992 and was a neat way of achieving an obviously sensible and just result.

IHT: Specialty Debts

Individuals with a foreign domicile are only exposed to inheritance tax in respect of assets situated in the UK. Assets situated abroad are excluded property and outside the scope of the tax. Accordingly, identifying where an asset is situated is rather important.

Specialty debts – generally those under seal – are regarded as situated where the document is physically located. This has been the common law rule since the dawn of time and has been clearly acknowledged by HMRC in their manuals. However, in January 2013 HMRC changed their view and said that specialty debts should be treated for inheritance tax purposes as situated where the debtor resides – corresponding with a general rule which applies for simple debts.

There was lots of indignation about this – but HMRC are perfectly entitled to change their view. It does not mean they are right – indeed they probably wrong and the point will no doubt be argued sooner or later.

Although, this is important for inheritance tax, it may not be of such significance for other taxes. There are statutory rules for capital gains tax, and for income tax purposes, the recent Court of Appeal decision in *Ardmore* confirms that the residence of the debtor is the crucial factor – the location of the physical document is of little or no relevance.

Foreign domiciled individuals with specialty debts located abroad (and trustees who may on this misinterpretation be subject to a 10 year charge) they may seek to protect themselves for example, by transferring the debts to a foreign incorporated company to secure excluded property status for the future. The shares in the company would be excluded property even if the specialty debt is not.

It seems that HMRC have now refined their view by taking different approaches where the specialty debt is secured or unsecured. Where the debt is secured on land or other property in the UK, they regard the situs of the debt to be in the UK. It is odd that they should think that the location of the security is so important as they were arguing in *Ardmore* that the residence of the debtor was the crucial factor. It will be interesting to see what will happen where there is a debt owed by a UK resident which is secured on non UK property.

HMRC also say that that unsecured specialty debts will generally be treated as situated where the relevant document is physically located. However if (shock horror) somebody were to remove a document from the UK to avoid inheritance tax, they would take the opposite view.

It is nice to know that HMRC have a consistent and reasoned approach to legal interpretation.

Access to Skeleton Arguments

The recent case of *Hastings Insurance Services Limited v HMRC and KPMG TC 6656* was a bit of a bombshell. More importantly, it presents a wonderful opportunity.

What happened in this case is that KPMG applied to the First Tier Tribunal for copies of HMRC's Statement of Case and both parties' skeletons. KPMG had a different case, but they thought that it would be useful to have sight of these documents. I bet they did.

Demonstrating a commendable degree of co-operation, the taxpayer and HMRC both objected to these documents being provided to KPMG for all sorts of reasons which would be readily understandable.

The Civil Procedure Rules (Rule 5.4C) provide for access to be allowed to records of the court – a matters which was examined in detail by the Court of Appeal in *Dring v Cape Intermediate Holdings Ltd [2018] EWCA Civ 1795* – but these Rules do not apply to the tax tribunals.

However, the Tribunal decided that they had an inherent jurisdiction to allow access to documents of a non-party if there was reason to do so. The Tribunal said that the test is whether the non-party had a legitimate interest in the documents. This is a broad test and it was enough that KPMG was seeking access to the documents to improve their understanding of HMRC's arguments in the appeal which were relevant to their arguments in a different case.

Goodness me, how incredibly helpful this could be. Maybe it is not that alarming in the sense that you can always turn up to the FTT and listen to the submissions being made. You would not get the Statements of Case that way – but you could listen to all the arguments which would cover all the relevant points, so being able to get the document which summarises them all, it may be not such a big deal. However, I can foresee a lot of applications being made following this case.

Non Resident CGT: Penalties

I have made frequent reference to the penalties for the failure to submit a Non-Residence Capital Gains Tax return and the excessively onerous nature of the obligations which seem almost to be designed to assist taxpayers to fall into error – which of course generates penalties for HMRC. (So, bad motivation or bad design? Either way, it must be wrong).

The penalty cases continue – on and on. There is an increasingly long list. The subject has gone completely mad. There are some judges who consistently and regularly say there should be no penalties for a number of reasons, both technically on the grounds that the penalty is not properly chargeable and even if it is, there is a reasonable excuse or there are special circumstances to eliminate the penalties. However, there are other judges who equally consistently and regularly take exactly the opposite point of view.

It is little short of scandalous that anybody appealing against the penalty knows whether they will win or lose depends entirely upon which judge they get. (This would seem to be the modern version of "*Equity varies with the length of the Chancellor's foot*" which I thought was condemned (and corrected) in the 17th century). It is certainly deserving of the cry "something ought to be done". I do not suppose that anybody minds which is the correct view – but we really are entitled to know what the right view is.

Although the amounts involved are important to the taxpayers involved, they are rarely enough to warrant an appeal (and the inevitable risks about costs) but I dare say that will happen in due course.

The sensible course would be for HMRC to make an amendment to put the matter beyond doubt, thereby eliminating a whole load of appeals to the Tribunal and a lot of reputational damage into the bargain.

Entrepreneurs Relief

Some details of a meeting with the Capital Taxes Liaison Group dealing with Entrepreneurs Relief and the definition of ordinary share capital were recently published. This is particularly interesting in the context of the case of *McQuillan* where shares with no dividend rights were held by the FTT not to be ordinary share capital because having no dividend rights was said to be equivalent to rights to dividend at a fixed rate of 0% – although this conclusion was reversed by the Upper Tribunal: *McQuillan v HMRC [2017] UKUT 0344.* HMRC set out a list of 13 circumstances where they consider shares are (or are not) ordinary share capital. It is too long to reproduce here but the list is certainly worth looking at, if the point arises.

The case of *Dieno George v HMRC TC 6678* was also concerned with the entitlement to Entrepreneurs Relief and the need to have a 5% shareholding or at least 5% of the voting rights. Mr George's shareholding was less than 5%, but there was an agreement that the other shareholders would provide him with 5% of the voting rights.

Mr George argued that because the other shareholders had agreed to do whatever was necessary to enfranchise his shareholding (thereby enabling him to qualify for Entrepreneurs Relief) this was an agreement enforceable by specific performance and under the maxim "*equity looks on that as done which ought to be done*" the shares should therefore be treated for the purpose of Entrepreneurs Relief as if they had the necessary voting rights.

What a great argument. And it nearly worked. The only reason it failed is because the agreement was not thought by the Tribunal to represent a legally enforceable agreement. The Tribunal judge said it was a goodwill agreement binding in honour only. That was enough to deny the relief – but this argument will surely be helpful in other cases.

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