UK Tax Bulletin

October 2018

Field Court Tax Chambers

FIELD COURT TAX CHAMBERS

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Latest Rates of Inflation and Interest

The following are the current rates at October 2018

Current Rates	
Retail Price Index: September 2018 August 2018	284.1 284.2
Inflation Rate: September 2018 August 2018	3.3% 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%

The Budget

A great deal has been written about Mr Hammond's latest Budget delivered on 29th October but there was not really a lot to get excited about – at least on a micro level.

I thought his speech was rather good (although that is no guide to anything) but maybe we could have done without some of the jokes. According to Mr Hammond we are on the threshold of Nirvana – but according to the other bloke, we are on the threshold of the Apocalypse. Neither probably.

There are going to be a load of changes to corporation tax: interest restrictions, charges on the property income and profits of non residents, controlled foreign companies, fragmentation etc. Lots of work for sure, but nothing which has not been announced before.

There is a huge but temporary hike (until December 2020) in the 100% Annual Investment Allowance from £200k to £1m and some changes to capital allowances generally. There is also a new relief called the Structures and Buildings Allowance which has remarkable similarities to the Industrial Buildings Allowance (of blessed memory). Maybe somebody could remind me why the IBA was abolished.

The concerns about a possible curtailment of Entrepreneurs Relief did not come to pass although from 5th April 2019 there will be an increase from 1 to 2 years in the period for which you need to hold the assets to qualify for relief.

There are also some changes to the definition of the 5% interest in a company which is necessary to qualify for the relief. Not only do you need to have 5% of the shares and 5% of the votes; you will now need to be entitled to 5% of the dividends and 5% of the assets in a winding up. That sounds simple enough – but watch out if the company has any preference shares or any other class of share. That would create exactly the same nightmare which has occurred with EIS shares where the existence of another class of share can unexpectedly (and almost inexplicably) cause the relief to be lost.

The suggested raid on pensions (or on pensioners) did not happen – although you never know, this might be introduced through the back door somehow.

There has been no end of criticism about the penalties for the failure to submit Non-Resident CGT returns and the excessively onerous obligations. HMRC have no sympathy; taxpayers ought to know the rules because they are all quite clear – except that not even the judges can agree what those obligations are.

Anyway, they have found a way to resolve this difficulty. They obviously did not want to abandon the system, or admit that it was flawed (and of course they could have done both), so from 6th April 2019 the capital gains tax payable by a non resident person on the disposal of UK residential property must be paid 30 days after completion. I guess the expectation is that the solicitors will deal with it just like they do with SDLT. That will solve the problem. (And there is a little note which says that this 30 day payment date for capital gains tax on residential property will apply to UK residents from 6th April 2020.)

It may be remembered that there is a hot dispute about the IHT treatment of additions to an existing settlement. Is an addition to an existing settlement an addition to an existing settlement (well, you would have thought so), or is it a new settlement? HMRC says it is a new settlement. So we have an announcement that legislation is to be introduced:

> "to reflect HMRC's established legal position in relation to the Inheritance Tax (IHT) treatment of additions to existing trusts. The legislation will confirm that additions of assets by UK-domiciled (or deemed domiciled) individuals to trusts made when they were non-domiciled are not excluded property."

At least that will deal with the arguments (although the reference to "HMRC's established legal position" is a bit of a cheek). However, this approach is so at variance with the existing legislative framework that I fear there will be a lot of unintended consequences unless they are extremely clever and get all the legislation to link together. I see the potential for another *Mansworth v Jelley* debacle here.

ATED is going up in line with inflation and the suggested 1% hike in SDLT for foreign buyers of UK residential property has been downgraded to a forthcoming consolation. Maybe somebody has whispered "careful what you wish for" in Mr Hammond's ear.

Damages for Tax Office Negligence?

Some interesting news emerges from the Canadian Courts. This may look like clutching at straws – but this could a very valuable straw.

The Quebec Superior Court recently held that the Canada Revenue Agency (the Canadian equivalent of HMRC) could be liable in damages for negligence if their actions caused measurable harm to the taxpayer.

In the case of *Ludmer v AG of Canada*, the Court held that the Canada Revenue Agency was negligent and had improperly conducted its tax audit by:

- Creating and refusing to abandon clearly untenable tax assessment positions.
- Making a request to the Bermuda authorities with reference to a "criminal tax matter".
- Acting improperly in attempting to railroad through a settlement.
- The failure to properly disclose information to the taxpayers.

The damages amounted to $4.8million

Goodness me! Does some of this look familiar? (Be still, my beating heart.)

I cannot imagine that the UK courts would readily adopt a similar approach in the current climate – but I have a feeling we might find out. After all, if HMRC were to be negligent or behave improperly causing harm to the taxpayer why should they be exempt from the consequences of their negligence or improper behaviour. Or, to put it another way – be above the law.

Such conduct would surely be an abuse and taxpayers should have a legal remedy – beyond perhaps Judicial Review which would merely tell HMRC to stop.

Tax Treaty Protection

The recent case of *Andrew Davies and others v HMRC TC 6733* discusses the overlap between anti-avoidance provisions such as section 720 Income Tax Act 2007 (transfer of assets abroad) and the protection provided by double taxation agreements.

The Tribunal decided said that the double taxation agreement actually provided no protection to the taxpayer – but the reasoning is not easy to follow from the judgment.

The taxpayer entered into various transactions involving life policies and an offshore company and there is no doubt that the arrangements would in principle fall within the transfer of assets abroad legislation because there was a transfer of assets whereby income became payable to a person not resident in the UK. The taxpayer claimed the motive defence (now in section 736) on the basis that the transactions were not undertaken with the purpose of avoiding tax. However, the motive defence was rejected by the Tribunal.

So far – nothing unusual.

However, the jurisdiction where the income arose was Mauritius with which we have a double taxation agreement. The treaty provided that the income was taxable only in Mauritius and not in the UK.

HMRC argued that the treaty did not give any protection to the taxpayers because they were not subject to tax in Mauritius on the income – it was the company which was entitled to the exemption. However, it was not the company that was being charged to tax under what is now section 720; it was the UK resident individuals to whom the income was deemed to accrue.

One can understand the mismatch argument here. The income arises to one person who is protected by the treaty – but the anti avoidance provisions deem the income to be the income of somebody else who is not so protected – and the exemption does not flow through. We are dealing with a complex anti-avoidance provision and it would be no surprise if we end up with a harsh result.

The Tribunal held that relief under the treaty would not have been available to the appellants had the income actually arisen to them and therefore there was no protection from the charge.

However, this would seem to be contrary to the decision in *Strathalmond v IRC 48 TC 537* and in *Bricom Holdings Limited v IRC 70 TC 272* where the Court of Appeal came to the opposite conclusion.

In *Strathalmond* the taxpayer's wife was a US citizen but not resident in the UK for the purposes of the UK/US treaty. Her husband was assessed to tax on her US dividends, but the Court held that he was protected because the dividends were exempt under the treaty. Similarly, in *Bricom*, which concerned other anti-avoidance provisions under the controlled foreign companies legislation, the company's income was deemed to be that of the taxpayer. Again, the treaty was held to provide the relevant exemption. The principle was expressed as follows:

> "Exempt income does not change its character or lose its exemption merely because it is deemed to be the income of another person or is imputed to him."

This would seem to be exactly the position with Mr Davies. The income of the company in Mauritius was deemed to be his for UK tax purposes and according to the Court of Appeal in *Bricom*, he should not lose the exemption merely because it is deemed to be his.

The Tribunal concluded that neither *Strathalmond* nor *Bricom* dealt with the transfers of assets abroad legislation and the facts were different from the present case. Well, yes. But facts are always different, and it is the principles which matter. The anti-avoidance provisions relating to controlled foreign companies which applied in *Bricom* were designed to have exactly the same purpose as section 720 – that is, to deem the income of one person to be the income of another for tax purposes. The statement that the income does not lose its character or exemption under a treaty for this reason, could hardly be clearer.

Decisions of the Court of Appeal are binding on the lower courts who need a pretty good reason for coming to a different conclusion. It would therefore have been helpful to have a more detailed analysis of the reasoning why the Court of Appeal decision in *Bricom* should not be applicable in a case concerning transfers of assets abroad.

Costs in the Upper Tribunal

One of the advantages for small taxpayers wishing to take their appeal to the First Tier Tribunal is that (unless they elect otherwise) they will not be liable for the costs of HMRC if they lose. However, this does not apply to the Upper Tribunal.

Accordingly, this advantage can be an illusion and actually represents a serious disincentive for the perceptive taxpayer in deciding to lodge an appeal. This is because the worst thing that can happen is for him to go to all the trouble (and expense) of a hearing before the FTT and win. If HMRC then appeals, he faces the prospect of another burdensome court hearing – with the risk of having to pay HMRC's costs if he loses.

So all HMRC has to do is to appeal (however, bad their case) and there is a good chance that the taxpayer will give in – particularly where the figures are comparatively small. HMRC do not take much risk with the lay taxpayer as his costs are likely to be negligible.

It is with this in mind that I read the recent letter from the Chartered Institute of Taxation to the President of the Upper Tribunal urging that where a taxpayer has won before the FTT, they should be able to opt out of the costs regime for the Upper Tribunal.

The point is powerfully argued. The CIOT highlight that it cannot be in the interests of justice for a taxpayer who has won in the FTT to be deterred from defending their case because of the risk of costs of the appeal. It is possible for the Upper Tribunal to direct that each side should bear its own costs, but that is exceptional.

Let us hope that the sterling (and selfless) work by the CIOT on this matter bears fruit, as a successful outcome to their representations must surely be welcomed by anybody with an interest in justice.

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