UK Tax Bulletin

February 2019

Field Court Tax Chambers

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FIELD COURT TAX CHAMBERS

Latest Rates of Inflation and Interest

The following are the current rates at February 2019

Current Rates	
Retail Price Index: December 2018 January 2019	285.6 283.1
Inflation Rate: December 2018 January 2019	2.7% 2.5%
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%

Goodwill

The recent case of <u>*Richard Villar v HMRC TC 6893*</u> considered the tax implications of a sale of goodwill by a professional person and is very helpful in clarifying the law in this area.

Mr Villar had a successful medical practice and he sold the business as a going concern to Spire Healthcare Diagnostics Limited for £1 million. Mr Villar said that the sale gave rise to a capital gain. However, HMRC argued that the payment was subject to income tax.

A crucial part of the HMRC argument was that the payment was mainly attributable to goodwill and they said it could not be transferred to Spire because the goodwill was personal to him.

HMRC also argued that there was no business to dispose of– it was really a payment in advance for the exploitation of Mr Villar's professional skills for a future flow of income. In other words, it was an arrangement for Mr Villar to obtain money in capital form (taxed at 10% having regard to entrepreneurs' relief), and not as income which would have given rise to rather more tax.

It is fair to say that when anybody buys a business, they are buying an income flow. They buy the business because the business makes profits and that is what provides the capital value. The purchaser may be able to exploit synergies with his own business or may feel that he has something to add to the business which will increase the profitability which makes it additionally attractive. When any business is sold, the vendor gives up the future profits which are subsequently received by the purchaser – but that does not mean every sale is therefore a sale of future income chargeable to income tax on the vendor. The sale of a business gives rise to a capital receipt chargeable to capital gains tax.

It was said to be common ground that the sale of a business is a capital transaction. The point was that HMRC said that this was not the sale of a business because Mr Villar did not have a business to sell.

That is a tough argument because Mr Villar certainly believed that he had a business capable of sale – and he sold it. The expert valuers who valued the business thought so too. And Spire obviously thought he had a business capable of sale because they paid £1 million for it.

The Tribunal did not take long to conclude that as a matter of fact, the sale by Mr Villar was a sale of his business and that the amount received was capital.

However, that was not the end of the story because HMRC argued that even if the payment was capital, it should be taxed as income under Section 773 ITA 2007 which brings into charge to income tax, a capital sum which is received to exploit the earning capacity of an individual in an occupation.

The FTT observed that there was no fixed intention or obligation for Mr Villar to continue to work in this way. On that basis it is difficult to conclude that the purchaser was exploiting Mr Villar's earning capacity. In reality (and in fact) Spire were exploiting the practice (and the goodwill) that Mr Villar had sold to them.

The second condition for Section 773 to apply is that one of the main objects of the arrangements was the avoidance of a liability to income tax. HMRC said that if Mr Villar had continued to receive the profits of his practice, they would have been chargeable to income tax whereas having sold the practice, he received £1 million which was chargeable to capital gains tax and eligible for entrepreneurs' relief. That is a substantial tax advantage – in fact a saving of the whole of the income tax.

However, the Tribunal found that there was no intention or desire to avoid or reduce income tax and, indeed, they saw no evidence that income tax was a matter which had been considered at all. Having regard to the huge tax saving involved, this was perhaps a view welcomed by Mr Villar, but it did not matter because the Tribunal found that Section 773 had no application in any event.

This case is important as it clarifies the tax position of goodwill of a professional practice which has certainly been the subject of controversy in the past. Unless there is an appeal (and press reports indicate there is not) this will obviously be a very helpful decision – even though decisions of the FTT have no precedential value.

Carelessness

There are numerous Tribunal cases dealing with penalties for carelessness. Some of them reveal matters of importance.

My eye was recently taken to the cases of *Negka v HMRC TC 6966* and *Omar v HMRC TC 6962*. Both taxpayers were unrepresented.

In the first case, HMRC penalised Miss Negka on the grounds that she had been careless in connection with her tax return and deserved a penalty. This was because, although she had looked at the HMRC published materials on line, "*a prudent person would have appointed a tax adviser*".

Before anybody gets too excited …. the FTT rejected this argument.

When we look at the case of Mr Omar, he was also penalised by HMRC on the grounds that he too had been careless and therefore deserved a penalty. However, we find that he was obviously a prudent person because he appointed two expert advisors. He should be OK then? Er, no. HMRC said that he was careless because: "*In order to avoid being careless, he should have looked at HMRC's published material.*"

I am not making this up. Fortunately, the FTT rejected this argument too – but that should not stop us getting excited about this.

What these decisions indicate is that the (unrepresented) taxpayers were being wrongly accused of being careless (and were wrongly charged penalties) simply because they did not agree with HMRC.

It is clear that the Tribunal carries an increasing heavy responsibility to protect the taxpayer from such an approach.

Dwellings

There are a number of Stamp Duty Land Tax issues where it is important to know whether a property is a dwelling – for example, it may determine the rate of SDLT payable from next to nothing perhaps to 15%. It may also be relevant to capital gains tax charge and inheritance tax.

The recent case of *PN Bewley Ltd v HMRC TC 6951* provides some helpful guidance. The case involved the 3% SDLT surcharge in Schedule 4ZA Finance Act 2003 which said that building counts as a dwelling if:

a) it is used or suitable for use as a single dwelling, or

b) it is in the process of being constructed or adapted for such use.

These words (apart from the reference to a *single* dwelling) are found elsewhere in the legislation – such as the definition in Schedule B1 TCGA 1992 for the non resident capital gains tax charge and for the new inheritance tax rules on UK residential property – and this decision may therefore be of wide application.

The key issue in this case was whether the property was "suitable for use as a dwelling".

This is obviously a matter where judgements can differ – which is a nice way of saying that cases will arise where the taxpayer will say that a property is suitable for use as a dwelling, and HMRC will say that it is not.

The FTT took the view that a building may be capable of being a dwelling but may be unsuitable for the purpose at the relevant time. This particular property was in a poor state with radiators and pipework removed (and the presence of asbestos prevented any repairs) and they concluded that it was not suitable for use as a dwelling.

HMRC did not agree and argued that the building was suitable for use as a dwelling – which was a bit odd having regard to their guidance notes which say that a dwelling is a building which affords those who use it the facilities for day to day private domestic existence – which clearly it did not.

Anyway, the discussion contained in this judgment about the various factors to be taken into account (or not taken into account) in deciding whether a building is a dwelling, could prove rather helpful in a number of different situations and a number of different taxes.

SDLT Filing

From 1st March 2019 the period for filing SDLT returns and paying the tax is reduced to 14 days from completion – or if earlier, the date of substantial performance, where the purchaser takes possession of the whole or substantially the whole of the property: section 46 Finance Act 2019.

In some circumstances, where further SDLT becomes payable, for example in the cases of linked transactions or where a relief has been withdrawn, the 30 day time limit continues to apply.

GAAR Panel Decision

The GAAR Panel have published their latest decision which relates to a claim for film related losses.

Whenever I read the decisions of the GAAR panel I am always troubled by the introduction where the Panel explain the conditions for their opinion. In case anybody thinks I am getting too sensitive, we all remember the "double reasonableness test" which was supposed to be a key safeguard for the taxpayer. Indeed, this test is enshrined in section 207 FA 2013 which says that "abusive arrangements" falling within the GAAR are:

> "arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances."

You would have thought that in deciding whether arrangements are abusive the GAAR Panel would need to have regard to this test. Unfortunately not; they have another test.

Schedule 43(11) says that when concluding that an arrangement is abusive, the members of the Panel must be of the opinion that:

> " the entering into or carrying out of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions having regard to those circumstances"

No double reasonable test there. So, what happened to the "key safeguard"?

Anyway, I can winge as much as I like – this is the law and we must get on with it.

So back to the film related losses which of course involved the investment by an individual into a film partnership which gave rise to lots of up front expenditure and an income flow later from the profits of the films.

The Panel said that:

> *"the overall policy objective of the film legislation is to provide a tax break in the form of a tax deferral; a potentially large upfront tax deduction with subsequent profits being subject to income tax".*

In this case the taxpayer got his upfront tax deduction, but the subsequent profits were not taxable because of the application of section 799 ITA 2007. The Panel said that there was a shortcoming in the legislation and the profits should be therefore be taxable. End of story – and no real surprise perhaps.

However, I think there is a real problem here.

If the profits were not taxable because of section 799 then why can it not be said that this was the intention of Parliament – which ought to be respected. The legislation must have been clear because otherwise a purposive interpretation of section 799 would have concluded that it was not applicable, and there would be no need to invoke the GAAR.

If the GAAR Panel say that they consider the policy objective is X and the legislation does not support it, then the views of the Panel take priority over the wishes of Parliament? I don't much like the sound of that.

Actually, this approach means that there is no need for legislation at all. The Panel can set out their view of the objectives in a couple of lines and it does not matter what the detailed legislation says. If the legislation supports their view then the Panel is right – and if the legislation does not support their view it must have contained a shortcoming, so the Panel's view is still right.

This may sound like a debating point – but it is really important to understand the significance of this because if you do something which gets the thumbs down from the GAAR Panel, you face a penalty of 60% of the tax: see section 158 Finance Act 2016. [That is not a typo – the penalty really is 60%].

I think we have come a long way from the GAAR prospectus which was to provide a mechanism for counteracting "egregious" tax arrangements which my dictionary defines as *shocking, appalling, horrific, horrifying, horrible, terrible, grievous, ghastly, hideous, and horrendous*. (That sounds more like a description of the penalty provisions than anything else).

I would suggest that if the GAAR were to be confined (as intended) to egregious transactions, it might be reasonably regarded as reasonable.

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