UK Tax Bulletin

May 2019

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 April 2019

Current Rates	
Retail Price Index: April 2019	288.2
March 2019	285.1
Inflation Rate: April 2019	3%
March 2019	2.4%
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 3.25% 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%

CGT: Entrepreneurs Relief

The rules relating to this valuable relief get ever more complicated. There have been changes introduced by the Finance Act 2019 which amend the conditions for the necessary 5% holding and also the length of time necessary for the shares to have been held to qualify for the relief. However, there are other important conditions needing to be considered.

One of these is the definition of "ordinary share capital" which has caused a number of difficulties – for example, the case of *McQuillan v HMRC [2017] UKUT 344* which concerned a holding of non-voting and non-participating shares. These were held to be ordinary share capital - and this completely wrecked the relief for those shareholders who held the real equity.

The definition of ordinary share capital is found in section 989 ITA 2007 and provides as follows:

> "Ordinary share capital means all the company's issued share capital (however described) other than capital the holders of which have a right to dividend at a fixed rate but have no other right to share in the company's profits".

In *McQuillan*, shares with no dividend rights were held not to be shares with a right to a dividend at a fixed rate, and they were therefore (surprisingly) within the definition of ordinary share capital.

Despite the Tribunal expressing the view that Parliament clearly intended that the relief should apply in these circumstances, there was nothing they could do to override the clear wording of the legislation. (I think that Mr Purposive Interpretation must have been on holiday).

A variation on this theme has arisen in the recent case of *Warshaw v HMRC TC 7107* where again the issue was whether preference shares were ordinary share capital. In this case the taxpayer was rather keen for them to qualify as ordinary share capital as he needed them to meet the 5% test for entrepreneurs relief.

The preference shares carried no rights to participate in the profits or assets of the company apart from a right to a 10% cumulative preference dividend on the following terms:

> "In priority to any other class of shares, each preference share shall have the right to a fixed cumulative preferential dividend (the preference dividend) which shall accrue on a daily basis from the dividend commencement date at a rate of 10% per annum…".

HMRC claimed that these preference shares were not ordinary shares within the Section 989 definition on the grounds that they were entitled to a dividend at a fixed rate. You can see their point.

Indeed, this is the published view of HMRC – set out in a document issued (with their approval) by the CIOT on 24th September 2018 in which they explained their view of various different types of preference shares in the context of the definition of ordinary share capital.

However Mr Warshaw said that the preference shares did not have the right to a dividend at a fixed rate. This was because the compounding calculation under the Articles meant that the amount of dividend receivable (and therefore the rate) was not fixed. It varied as a result of the current and the unpaid elements of their entitlement.

The Tribunal accepted this argument with the result that the preference shares were ordinary share capital. Mr Warshaw therefore satisfied the 5% shareholding requirement and was entitled to entrepreneurs' relief.

I have a feeling that this ingenious argument may well have been overlooked in other cases. I imagine that many people (me included) might have simply looked at the terms of the preference shares, found that they were entitled to a fixed rate of preference dividend (cumulative or otherwise) and thought no more about it. A detailed analysis of the Articles of Association and the way the dividend rights apply to cumulative preference shares, may provide another interpretation.

SDLT: Section 75A

Section 75A FA 2003 is really important in considering liability to SDLT because it enables HMRC effectively to reconstitute a contract between the parties and to charge SDLT on the basis of a notional contract where a higher charge to SDLT arises.

In the case of *Project Blue v HMRC [2018] UKSC 30* the Supreme Court explained that the reason HMRC are able to undertake this alchemy is because Section 75A was introduced to "to catch a range of tax avoidance schemes and prevent unintended tax losses by the use within the series of transactions of a combination of reliefs and exemptions".

However, the Supreme Court also explained that although section 75A is expressly an anti-avoidance provision, no tax avoidance motive is necessary for Section 75A to apply. If the transactions could be undertaken another way which would give rise to a higher charge to SDLT, HMRC are broadly entitled to charge tax on that basis.

This principle has been challenged head on by *Hannover Leasing Wachstumswerte Europa VI GmbH & Co KG v HMRC TC 7102*. Hannover wished to acquire an office building in London which was owned by a unit trust. They purchased the units in the unit trust rather than the underlying property. There were a number of wholly commercial and non tax related reasons for doing so.

Hannover set out impressive and detailed explanations why the transaction was normal, legitimate and commercial without any tax avoidance motive, and a number of reasons why Section 75A should not apply in these circumstances. They also pointed to the specific guidance published by HMRC which was that a transaction of this nature would not be subject to section 75A. They thought this was both relevant and something on which they were entitled to rely.

In a lengthy judgment, the FTT decided that transaction did fall within Section 75A and the published HMRC guidance was either irrelevant or wrong.

Accordingly, even though the transaction involved a number of commercial elements unrelated to tax, section 75A allowed them all to be notionally rearranged to give rise to a higher charge to SDLT.

The FTT found that one of the transactions was intended to save SDLT – although no suggestion was made that any tax avoidance was involved. (If a tax saving motive is not relevant to the application of section 75A, one might wonder why this is important). Even odder was the suggestion by the judge that if the transactions had been undertaken in a different order, section 75A might not have applied at all. Can it really be the case that the order of the transactions is crucial in an anti-avoidance provision? In any event, the reasons why the transactions took place in that particular order were entirely commercial.

Presumably there must be some limits on HMRC dreaming up a transaction and charging tax on it – but it is bit difficult to see what they might be at the moment.

Transactions in Securities

Spotlight 47 issued by HMRC makes chilling reading. From 6th April 2016 section 396B and 404A ITTOIA 2005 provide that where a close company is liquidated and within a period of two years, the individual shareholder is involved with a similar trade or business, the proceeds of the liquidation will be charged to income tax and not capital gains tax.

This will apply where:

> "it is reasonable to assume, having regard to all the circumstances, that the main purpose or one of the main purposes of the winding up is the avoidance or reduction of a charge to income tax"

This is going to catch a lot of innocent people – including I expect some who are professionally advised – because it will bite in circumstances when nobody imagines that the normal tax rules are replaced by a really penal regime. You wind up your company and entrepreneurs relief means that you pay only 10% tax – and only on the capital gain. Whoops. Actually there is an income tax charge at 45% on the whole of the proceeds (or maybe 38.1%, but what does it matter).

A question might arise whether the intention to pay capital gains tax on the liquidation proceeds means that one of the main purposes was not to pay income tax. Who knows – but it must be a likely argument. And subsection 6 says the fact that a similar business has been started within two years is specifically a relevant circumstance. That sounds like a presumption to me.

Unfortunately, it gets worse. What Spotlight 47 says is that these provisions also apply to the sale of a company to an independent third party at market value. Even expert advisors are going to have to be really alert not to miss that – the lay taxpayer does not stand a chance.

HMRC say (well they don't actually say, but they suggest) that they would not apply these rules in the case of a straightforward sale. Unfortunately, history shows that they will apply them whenever they want and say it is the will of Parliament –

and, (sorry?- no I don't think so) there is nothing they can do. For just one example, look at *Lobler* (and weep) – and for another look at *Flix Innovations* (and weep some more) and for a third ….

Maybe the more wide eyed taxpayer will take comfort from what HMRC say without realising that their guidance, and their Manuals, offer no protection. For those who think this is a cynical view, just look at *Hannover* (see above) – and for another, look what they said in *Aozora GMAC Investments*, and for a third….

It would be nice to have a clear statement from HMRC sufficient to provide the taxpayer with a legitimate expectation so that at least he has a remedy – even though an application for Judicial Review would cost him a fortune. Or maybe a decision of the Courts that these provisions do not really go that far.

However, I read that the CIOT and the ICAEW are on the case, which is excellent news. They are sometimes able to reach the parts that others cannot reach in their pursuit of fairness for taxpayers.

Discovery Assessments

The decision of the Court of Appeal in *HMRC v Raymond Tooth [2019] EWCA Civ 826* has now been published, and very interesting it is too. And important – because virtually all of the decisions on this subject have been at the lower level.

The Court of Appeal considered whether HMRC had made a valid discovery of an insufficiency of tax in Mr Tooth's tax return and whether a discovery assessment could be issued. The Court of Appeal decided it could not – although without referring to the word "stale" at any point. They merely referred to the essential newness of the discovery by the tax officer.

Another significant aspect of this case was the claim by HMRC that Mr Tooth was guilty of "deliberate behaviour" thereby entitling HMRC to an extension of time in raising assessments and a whole lot of nasty consequences. Such consequences follow where the conduct of the taxpayer is, according to the Upper Tribunal, tantamount to fraud, and which has been described elsewhere as involving dishonesty.

The allegations which had been made by HMRC of deliberate behaviour on the part of Mr Tooth, were abandoned and not pursued by HMRC before the Court of Appeal.

Notices to File Tax Returns

There has been a series of decisions by the FTT dealing with the validity of the issue of tax returns. It seems to me that this may have wide ranging implications.

In the case of *Clare Platt v HMRC TC 7131* the taxpayer was charged a penalty for failing to send in her tax return on time. She denied ever receiving the notice. As this was a penalty matter, the onus was on HMRC to prove that they had issued a notice to her requiring the submission of a tax return: section 8 TMA 1970.

Unfortunately they were unable to do so. HMRC produced a document entitled "Return Summary" which included a "Return Issue Date" of 6th April 2017. However, the judge said this fell well short of being sufficient evidence to prove that the notice was actually sent to her.

The really important bit was the judge's explanation that every Return Summary had the same issue date of 6th April – and he said that HMRC could not have sent out all the returns on that date, because:

> "logistically, it simply could not hand over to the Royal Mail the huge volume of letters which it would need to send if every relevant taxpayer was sent a notice to file on the same day of each year…. The record is therefore inherently improbable and unreliable."

Therefore, there was no good evidence to show that a notice had been issued to Clare Platt and no penalty could be charged.

But surely this applies to everybody. We all receive a notice to file a tax return and all the notices we receive must be equally flawed. So nobody should be charged a penalty for late filing of a tax return unless they admit to having received it – thereby proving HMRC's case for them.

Unfortunately, I do not think that this means that we do not have to send in tax returns any more. We have an obligation to notify chargeability under section 7 TMA 1970 within 6 months of the end of the tax year if we have any income or chargeable gains for that year. Naturally, there are penalties for failing to notify chargeability. We also need to pay the tax on the due date, and there are penalties for not doing that. But these are entirely separate from a late filing penalty.

As a result of this (and the numerous other cases), I bet that there will be loads of people appealing against late filing penalties and something is bound to happen soon. I wonder what.

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