UK Tax Bulletin

June 2019

FIELD COURT TAX CHAMBERS

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Latest Rates of Inflation and Interest

The following are the current rates at May 2019

Current Rates	
Retail Price Index: April 2019	288.2
May 2019	289.2
Inflation Rate: April 2019	3%
May 2019	3%
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%

Purposive Interpretations

The Supreme Court has provided fresh guidance on purposive interpretations in the case of *Hancock v HMRC [2019] UKSC 24*.

In broad terms, the taxpayer disposed of his shares in a company for Non-Qualifying Corporate Bonds enabling the capital gain to be rolled over into the non-QCBs under the normal rules for reorganisations under 127 TCGA 1992. When the non-QCBs were disposed of or redeemed, the capital gain arising on the disposal would become chargeable. No problem – so far.

However, the non-QCBs were subsequently converted into QCBs. This is very significant because QCBs are not chargeable to capital gains tax. The conversion into QCBs did not give rise to any charge to capital gains tax, and when the QCBs were eventually disposed of, no charge to capital gains tax arose then either. Magic.

It is no surprise that this disappearing trick attracted an unfavorable reaction from HMRC. The Upper Tribunal agreed with them that this did not work to eliminate the capital gain, and so did the Court of Appeal. The Supreme Court has now provided a definitive view on the matter. It certainly did not work.

However, the judgment of the Supreme Court contains some worrying passages. But, worrying or not, a decision of the Supreme Court represents the law and is beyond question. Their judgment is by definition correct. If I find it worrying, the fault is mine for failing to understand the analysis.

The concern from the decision in *Hancock* is how far a purposive interpretation can extend. The Supreme Court said that the wording of the legislation provided powerful support for the argument of the taxpayer, which I understand to mean that the wording of the legislation provided the relief he was seeking.

However, the Supreme Court explained that their view of the purpose of the legislation did not correspond with the wording, and it was therefore necessary for them adjust the wording, or leave out words, so that it did correspond to that purpose.

I was always taught that the intention of Parliament had to be found from the words used by Parliament in the statute, rather than the other way round, but perhaps my age is showing and this is too old fashioned a view.

The problem is – where does it stop. And how can any citizen ever know what the law is, if the clear words of the law can be adjusted many years later to what the courts think the law ought to have been.

It might be hoped that such a purposive interpretation could be applied in favour of the taxpayer, and not confined to interpretations of HMRC. Indeed, the Supreme Court confirm exactly that, referring to *Luke v IRC [1963] AC 557* where a purposive interpretation was applied to prevent an unreasonable tax charge.

That sounds very helpful – except that my mind goes to the case of *McQuillan* where the Upper Tribunal felt bound to follow the wording of the legislation and deny Entrepreneurs Relief – although they said it was clear that the legislation was designed to give relief in the taxpayer's circumstances. And *Lobler* where the FTT said the the legislation was outrageously unfair but they dismissed the appeal (with heavy hearts) because there was nothing they could do about it.

However, maybe there is hope for such cases in the future.

And so there is…

Vermillion Holdings Ltd

Just before the decision of the Supreme Court was published, the FTT decision in the case of *Vermillion Holdings Ltd v HMRC TC 707* was released. Hold on to your hat.

This case concerned the grant of a share option to an employee and whether it should be taxed as earnings having been made available by reason of his employment.

In very broad terms, the Tribunal found that as a question of fact, the option granted to the employee was an opportunity made available to him by the company. However, the Tribunal also found that, as a question of fact, the option was not granted by reason of his employment.

OK so far – except for a deeming provision in s 471(3) ITEPA 2003 which says:

> "a right or opportunity to acquire a securities option made available by a person's employer or a person connected with the person's employer, is to be regarded of the purposes of subsection 1 as available by reason of an employment of that person…"

HMRC argued that as this was exactly the case here and section 471 deemed the option to be provided by reason of his employment. End of.

However, the Tribunal did not see it that way. The judge said that she had decided as a question of fact that the employment was not the reason for the grant of the option. She then explained that:

> "an anomaly therefore arises between a statutory fiction as a result of the deeming provision under subsection 3 and my finding the fact that the option was not granted by reason of his employment…. The ambit of the deeming provision should be limited where the artificial assumption from deeming is absent with the factual reason that gave the right to require the option".

I would respectfully suggest that the whole point of a deeming provision is to do exactly that – to override the factual position and to ensure that the opportunity is taxed on this basis, even where the real facts are otherwise. Indeed, one might say that a deeming provision is completely useless if it has to give way to the facts. If the facts show that this is the case, you would not need a deeming provision at all.

Anyway, the Tribunal decided that the deeming provision could not be applied and the option was not taxable.

This is a very interesting interpretation and the analysis might prove extremely helpful in future. But before I get carried away, maybe I should wait and see whether there is an appeal.

Corporate Residence

The case of *Development Securities Plc (and Others) v HMRC [2019] UKUT 169* has now been heard by the Upper Tribunal. It was concerned with whether the Jersey subsidiaries of Development Securities Plc were resident in the UK or in Jersey. This is a familiar issue on which there is lots of authority.

It was all to do with the classic test of corporate residence being the place of Central Management and Control. This was famously explained by Lord Loreburn in *De Beers Consolidated Mines v. Howe [1906] AC 455* where he said that we must look to see where the company keeps house and does business, and where the chief seat of power is found. The central management and control abides where the real business carried on.

More recently in Wood v. Holden [2006] EWCA 26 the Court of Appeal held that in the case of a parent and subsidiary, it is not enough that the subsidiary makes decisions in accordance with the parent's wishes. The central management and control test distinguishes between influence and control. Mere influence is not enough. There is a difference between usurping the power of the board to take decisions concerning the company, and ensuring that the board knows what the parent company desires the decisions to be. Only where the parent controls the subsidiary by taking decisions which should properly be taken by the directors, does the central management and control vest with the parent.

In the case of Development Securities the FTT acknowledged that the Jersey companies were operated by highly experienced professionals who behaved entirely properly at all times. They gave full and independent consideration to all the questions facing them, and would certainly not have been susceptible to being leant on by a third party. Their decisions were documented by full minutes.

Nevertheless, the FTT decided that the Jersey subsidiaries had no commercial objective to their decisions and concluded that the central management and control was exercised at a higher level, namely in the UK where the decision to use the offshore company for wider group purposes was taken.

It is interesting that although the decision making process and the decisions of the directors were reflected in the minutes signed by all the directors, the FTT regarded those minutes as less important than the notes taken by an administrator who was not even present at the appeal hearing. The FTT made frequent references to her notes saying:

> "Whilst we accept that the typed minutes are important evidence, we regard them as somewhat secondary to Ms Hembury's notes".

It is an odd concept that the formal minutes of board meetings signed by all the directors who took the decisions should be disregarded in favour of some handwritten notes by an administrator. The FTT was at pains to say that the directors did not act in any way improperly – so why their carefully considered and fully documented decisions should be disregarded is difficult to understand.

Anyway it does not matter because the Upper Tribunal has allowed the appeal, deciding that the Jersey directors did not abdicate their decision making responsibility and that the FTT was wrong in saying that they were merely following instructions of the parent.

The Jersey directors understood the issues and properly applied their minds to the relevant transactions with the result that the central management and control was exercised in Jersey.

The Upper Tribunal set out a lengthy series of propositions following the principles in *De Beers* and *Wood v Holden* set out above but noting crucially that the court must be astute to detect shams, where a company appears to have its central management and control in one country whereas in reality it is exercised by another body in another country. It is a question of fact which is determined by a scrutiny of the course of the business and trading.

SDLT: Section 75A

The CIOT have published a note explaining that a statement has recently been added to the SDLT Manual explaining that the HMRC guidance has not (yet) been updated to reflect the Supreme Court decision in *Project Blue* which was all to do with the application of section 75A FA 2003.

The CIOT rightly point out that this gives the unwary reader a warning that the HMRC guidance on this important subject cannot be relied on to represent accurate guidance.

I guess it might be said that because section 75A is an anti-avoidance provision, anybody likely to fall within it is bound to know about *Project Blue* and would not be misled by the Manual. However, anybody who has read the case of *Hannover Leasing Wachstumswerte* (see last month's bulletin) will know that the scope of the section is so wide that perfectly ordinary transactions containing no tax avoidance motivation are caught by section 75A.

HMRC say that they will update the guidance at the earliest opportunity – which will clearly be welcome.

HMRC Letters: Offshore Income

The CIOT has been busy on our behalf and have issued a note about a standard letter being written by HMRC where they have received information indicating that a taxpayer has foreign income or gains.

The extensive new information sources available to HMRC mean that they get an enormous amount of information and they naturally want to check whether there have been any omissions from individual's tax returns.

In principle that seems absolutely fair – and indeed very helpful as a reminder in case anything has been overlooked. However, some people see it differently – particularly as the letter tells them that they should sign and return a certificate confirming their tax position (with references to awful penalties). The certificate contains the same declaration that was on their tax return (except that it is unlimited in time) – so a taxpayer may wonder why he should have to do it again.

The CIOT confirm that there is no legal authority for HMRC to require such a certificate and that people "should consider very carefully whether to sign and return the certificate". This looks like code for *Don't Do It*. Indeed, they give the same advice where the taxpayer has irregularities to disclose; they suggest that a response by letter would be good practice.

Despite the irritation it will cause in many cases, some response to the letter would clearly be wise because ignoring it would inevitably result in some kind of further action by HMRC (well, it would, wouldn't it) which is bound to be unwelcome.

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