UK Tax Bulletin

September 2019

FIELD COURT TAX CHAMBERS

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Contents

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Latest Rates of Inflation and Interest

The following are the current rates:

Current Rates	
Retail Price Index: August 2019 July 2019	291.7 289.5
Inflation Rate: August 2019 July 2019	2.6% 2.8%
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 0.50%

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%

EBT Loan Charge

The Prime Minister recently announced that a thorough review would be made of the situation relating to the EBT loan charge which came into force on 6th April 2019. This was swiftly followed by a statement by the Chancellor of the Exchequer that he has commissioned an independent review.

It is difficult to know what to make of this. There were some really serious criticisms of the loan charge at the highest level and the matter has already been reviewed – but nothing happened.

And what about those people on whom a liability arose on 6th April 2019 under Schedule 12 Finance (No. 2) Act 2017. It is the law after all.

Perhaps the Prime Minister will conclude that all the criticisms which have been made about the loan charge are well-founded and it should be withdrawn retroactively.

Or perhaps he won't.

Sale of Goodwill

Having regard to the extraordinary events of the summer, my eye was drawn to the recent Tribunal decision in *Leeds Cricket Football & Athletic Company Limited v HMRC TC 7362* which concerned the capital gains tax implications of a sale of Headingly Stadium.

Not everybody will be aware of the significance of Headingly. It will probably mean little to the Ayoreo Tribe of the Amazon, and some of the inhabitants of Mars but for others, Headingly is revered as the location of the most astonishing sporting events – and the home of legends.

Anyway, before I get carried away, I would explain that the issues before the Tribunal related to the capital gains tax consequences of the sale of the stadium

The company owned the freehold of the property which it leased to Yorkshire County Cricket Club. In December 2005 the freehold was sold to the Cricket Club together with the commercial businesses.

The company had been carrying out three distinct activities; hospitality, catering and advertising. The question was whether these operations constituted a business carried on by the company prior to the sale.

The parties certainly thought so because the sale contract included a specific provision that the property and the goodwill of the businesses were to be sold, and the contract defined goodwill in great detail. There was also a deed of assignment of the goodwill pursuant to the contract.

HMRC argued that the sale was not the disposal of a business and the associated goodwill but merely a transfer of land with attached income streams. This gave rise to rather different tax consequences. They said that the income streams were not capable of existence without the land and no business was carried on. Failing that, even if a business was carried on, no goodwill attached to the business.

These arguments were all roundly rejected by the Tribunal. The Tribunal held that the company clearly carried on a business. The activities satisfied the test of being a serious undertaking which was earnestly pursued and was conducted in accordance with recognised business principles. Accordingly, the company did transfer the property and the business, including the goodwill associated with the business, and that the transaction was not merely a transfer of land with attached. The goodwill of the business was not subsumed into the value of the property.

These arguments, that there was no business capable of transfer and that there was no goodwill in any event, are reminiscent of those advanced by HMRC in *Richard Villar v HMRC TC 6893* relating to the goodwill of a professional practice which was heard earlier in the year. The Tribunal rejected those arguments as well, holding that there was indeed goodwill and that it was in fact transferred.

HMRC clearly have some independent views regarding goodwill and the sale of businesses and I doubt whether we have heard the last of them.

I think it would be interesting for HMRC to attend a meeting where somebody (I mean a real person) is trying to buy a business and let them see the reaction when the purchaser refuses to pay anything for the goodwill on the grounds that no goodwill exists. They might be in for a surprise.

Entrepreneurs Relief

Entrepreneurs' relief is such a valuable relief that there are constant fears that it may be withdrawn. Let us hope not. But even while it exists, the conditions for entrepreneurs' relief are being regularly stress-tested by HMRC.

One of the difficult tests for entrepreneurs' relief is whether the company has substantial non-trading activities. When entrepreneurs' relief is claimed on shares in a company, the company must satisfy the trading company definition in section 165A(3) TCGA 1992:

> "a company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities".

What is meant by "other than trading activities" and what is meant by "a substantial extent" is unclear – although HMRC have unilaterally adopted 20% as being substantial. 20% of what, you may ask – to which their answer is (of course) that it depends. The respective turnover, assets, expenditure and time spent by the employee on the activities are factors which might be considered.

One particular problem relates to the accumulation of cash from the company's trading profits. A successful trading company will naturally make profits which will result in increasing amounts of cash which has to be put somewhere and it may be invested in conventional financial investments. This is not a problem for inheritance tax business property relief because the company would still a trading company and not wholly or mainly making or holding investments: section 105(3) IHTA 1984.

However, for entrepreneurs' relief, it can be argued that if a company has more than 20% of its assets in conventional investments it could be at risk of losing entitlement to entrepreneurs' relief. This would not be a proportionate reduction – it is all or nothing. Accordingly, the holding of cash and investments from the of the company's successful trading carries with it a clear risk.

It is therefore interesting to read the case of *Potter v HMRC* TC 7348 where the Tribunal examined this position.

The approach of HMRC in this case was that even if the company was carrying on trading activities, the investment of its profits into bonds which represented most of the assets of the company was an investment activity, and was substantial, and this precluded the company from being a trading company.

Mr Potter was a broker and dealer on the London Metal Exchange and his company arranged credit deals for clients to engage in high value trading on the LME. These deals were complex and could take months. As a result of the crash in 2008, banks withdrew credit lines, there was little credit available and not much appetite for risk among the clients. The volume of trades declined dramatically.

The company put their available cash into some investment bonds, not because they wanted to "sit back and live off the income" but to safeguard the company's accumulated profits until the next trading opportunity arose.

The Tribunal concluded that the expenditure and the time spent by the company's employees on the non trading activities was nil. The company had put its money into bonds and did not do anything else in relation to them. There were no investment activities.

The Tribunal said that the assets and income position of the company were factors against trading activities, but the expenses incurred and the time spent by the employees were factors pointing towards trading activities. When one stands back and looks at the activity of the company as a whole and asks "what is this company actually doing" the answer was that the company was entirely a trading company and its activities were directed at reviving the company's trade and putting it in a position to take advantage of the global financial conditions as they change.

Accordingly, the Tribunal found that the activities of the company did not to a substantial extent include activities other than trading activities and the shares therefore qualified for entrepreneurs relief.

This is a welcome confirmation of the position and does not conflict necessarily with the HMRC guidance in CG 53116 as that concentrates predominantly on the "activities" which may be non-trading activities – rather than where there are no such activities.

Personal Service Companies

The tax position surrounding personal service companies and in particular, those relating to TV presenters, is becoming seriously confused.

It may be that the new rules which are proposed for next year will clarify the position – or at least bring a measure of certainty, despite their unpopularity and the widespread criticisms which they have attracted. (This seems to be a familiar theme just at the moment).

The latest ingredient in this particular pot is the decision of the FTT in *Paya Limited, Tim Wilcox Limited and Allday Media Limited v HMRC TC 7377*. In a 177 page judgment following a hearing in May 2018, the Tribunal decided that IR 35 applied to two of the presenters - but not the third. The distinction surrounded the precise effect of the concept of mutuality of obligation, which is itself a controversial concept. And one of the two Tribunal judges considered that none of the presenters were within IR 35 at all.

The analysis is very comprehensive, although no reference is made to the conflicting cases of *Christa Ackroyd* and *Lorraine Kelly* so we are no nearer to understanding what this all really means. Maybe the Upper Tribunal in *Christa Ackroyd*, the judgment of which is awaited, will bring some clarity.

A particularly unattractive feature of this case was HMRC's allegation of carelessness on the part of the advisers to the taxpayer. Having regard to the direct conflict in *Christa Ackroyd* and *Lorraine Kelly* and the fact that the Tribunal judges in this case took opposing views, it is a bit difficult to suggest that any adviser could be careless in coming to either view on this subject. The view of HMRC seems to be that you are careless, and deserving of a penalty, if you do not agree with their view.

The Tribunal did not consider that the advisers had been careless, but I doubt whether we have heard the last of this argument either.

Where the taxpayer has been careless (i.e. they had not taken reasonable care), HMRC can go back 6 years. But if their conduct had been "deliberate" that is much more serious and they can go back 20 years – and of course the penalties for deliberate conduct are much larger than for mere carelessness.

Strangely, HMRC's arguments in this case indicate that in their view, careless conduct is considerably more culpable than deliberate conduct. Indeed, in *Cliff v HMRC TC 7358* they persuaded the Tribunal that deliberate conduct does not even require carelessness. Apparently, conduct is deliberate if it is not accidental (e.g. the dog hit the send button before I could stop it), even if the taxpayer had taken reasonable care and was not careless.

This surely cannot be right, and it will be interesting to see what happens next.

HMRC Enquiry Notices

The Court of Appeal have recently provided some important guidance regarding the requirements for the issue by HMRC of an enquiry notice under section 9A TMA 1970: *Tinkler v HMRC [2019] ECWA Civ 1392.* The decision is lengthy but the key issue was whether a valid notice of enquiry under Section 9A of an intention to enquire into a tax return can be made by sending the notice to the taxpayer's agent.

The Court of Appeal said it could not. The notice of an enquiry under Section 9A must be given to the taxpayer and it is not something which can be sent merely to the agent. The specific requirement of section 9A is for the notice to be given to the taxpayer.

Form 64-8 provides HMRC with authority to correspond and otherwise disclose information regarding the taxpayer to the nominated agent. However, form 64-8 expressly excluded Section 9A notices as a document which HMRC could send to a taxpayer's agent only.

This is an important point of clarification at virtually the highest level and can hardly be challenged further. I dare say there will be some fall-out in due course.

Main Residence: Garden or Grounds?

Everybody knows that there is a capital gains tax exemption for the principal private residence and that this extends to land which the taxpayer has for his own occupation and enjoyment with that residence as its garden or grounds up to half a hectare: Section 222(1)(b) TCGA 1992.

It is possible to obtain the exemption for a larger area of surrounding land where that larger area is required for the reasonable enjoyment of the dwelling house as a residence having regard to its size and character: section 222(3).

Some large houses have substantial areas of surrounding land – lawns, a lake, a paddock, perhaps an arboretum, or even an airstrip, which would obviously extend to rather more than half a hectare.

The question will be whether or not this additional land represents the garden or grounds - so the meaning of *grounds* in this context is rather important.

The recent case of *Hyman v HMRC* TC 7271 examined the meaning of grounds in the case of a residential property and although this was for Stamp Duty Land Tax purposes, the definition of grounds would seem to be broadly the same.

Interestingly, for capital gains tax purposes, it is invariably the taxpayer who is seeking to claim that the relevant area represents garden or grounds and therefore part of the residential property for the purposes of the exemption. In this case, the taxpayer was claiming that the extra land was not part of the residence so that a lower rate of SDLT applied and it was HMRC who were arguing that the grounds represented part of the residential property.

Section 116 Finance Act 2003 defines residential property for SDLT purposes as:

> "land that is or forms part of the garden or grounds of a building [which is used or suitable for use as a dwelling]."

HMRC's view was that any land surrounding a residence (and in the same ownership) represented *grounds* and the Tribunal agreed with this proposition if the land was available to the owners of the house to use as they wish. The Tribunal held that the section did not imply any requirement for active use by the taxpayer.

This sounds pretty helpful in the context of a capital gains tax claim for exemption except that Section 222 TCGA 1992 provides an additional requirement which is that the land must be "land which he has for his own occupation and enjoyment with that residence".

However, there is no requirement for use in any particular way and enjoyment could be much more indirect – for example, the views of the rolling acres (including the lake and arboretum, or pasture) – which could give rise to significant and positive enjoyment. It certainly would if you compare it with the alternative of having your neighbour build a factory, or a racing car test track, the other side of your boundary.

I note that HMRC have revised their SDLT Manual in the light of this decision and confirm that rights of way over land do not stop it from being grounds nor do the grounds need to be used for any particular purpose. Allowing grass to grow wild to form a meadow did not stop the land being grounds of the property.

The rules relating to SDLT and to capital gains tax are not the same, but this case will clearly be of some assistance to those wishing to claim capital gains tax exemption from a gain on the disposal of a large residence.

Peter Vaines
Field Court Tax Chambers
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Contact
Peter Vaines
Field Court Tax Chambers
3 Field Court
Gray's Inn
London WC1R 5EP
Tel: 020 3693 3700
pv@fieldtax.com
www.fieldtax.com