UK Tax Bulletin

August 2020

Field Court Tax Chambers

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Latest Rates of Inflation and Interest

The following are the latest rates: July 2020

Current Rates	
Retail Price Index: June 2020	292.7
July 2020	294.2
Inflation Rate: June 2020	1.1%
July 2020	1.6%
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 rate of 2.6% from 9th April 2020.

There is one exception: Quarterly instalments of corporation tax bear interest at only 1.25% from 23rd March 2020

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.

Official rate of interest

To 6th April 2015:	3.25%
To 6th April 2017:	3%
To 6th April 2017:	2.5%
From 6th April 2020	2.25%

IHT: Omission to Exercise a Right

The basis of the charge to inheritance tax is on the value transferred by a chargeable transfer; that is a transfer of value made by an individual other than an exempt transfer.

Section 3 IHTA 1984 defines a transfer of value as a disposition as a result of which the estate of the transferor is less than it would be but for the disposition.

This gives rise to the general principle that the charge to inheritance tax is not on the value of the subject matter of the gift or bequest but on the value by which the transferor’s estate is diminished. The example often quoted is the gift of a 2% shareholding which takes the donors shareholding from 51% to 49%. The 2% is worth very little but the difference in clause between a controlling 51% shareholding and a minority 49% holding could be colossal.

Things can get more subtle and section 3(3) IHTA 1984 covers the situation where somebody omits to exercise a right. Section 3(3) provides that:

> “Where the value of a person's estate is diminished, and the value—
>
> (*a*) of another person's estate, or
>
> (*b*) of any settled property, other than settled property treated by section 49(1) below as property to which a person is beneficially entitled,
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> is increased by the first-mentioned person's omission to exercise a right, he shall be treated for the purposes of this section as having made a disposition at the time (or latest time) when he could have exercised the right, unless it is shown that the omission was not deliberate.”

This became an important matter in connection with pension schemes because many people do not take their pension benefits as soon as they arise. Why do that when you do not need the income – especially if you would have to pay tax at (maybe) 45% on it. And of course the money can stay in the pension scheme where it can be invested gross - and be free of inheritance tax.

This sounds like good thinking - except that HMRC took the view that because you could have drawn your pension before you died, omitting to do so was a transfer of value under section 3(3) so it was not free from inheritance tax after all.

Did we all know that the IHT exemption for pension schemes only really applied to those who died before reaching pension age? Of course we didn't – and section 151 IHTA 1984 which provides the exemption does not say so either.

This obvious unfairness was eventually corrected by the Finance Act 2011 to the effect that the omission to exercise rights under a registered pension scheme or a QNUPS is specifically outside the scope of section 3(3).

Unfortunately, this was not soon enough for Mrs Staveley whose case has recently found its way to the Supreme Court: *HMRC v Parry and others [2020] UKSC 35*.

Mrs Staveley was gravely ill and in the knowledge that she did not have long to live she arranged a transfer from one scheme to another which provided better death benefits. She did not draw her pension (which she could have done) and when she died the money went to her sons, ostensibly free of inheritance tax. Unfortunately not. HMRC said that she deliberately omitted to take her pension intending that her sons would benefit. So under Section 3(3) the transfer of value took place at the last time that she could have exercised her right to draw the pension benefits which was the moment immediately before her death.

(There is philosophical point here because section 4 provides that the value of a person's estate for the purposes of IHT is "*the value of his estate immediately before his death*". But immediately before the death the rights still existed. So could the rights both exist, and have ceased to exist, at the same time? I did not expect to find Schrodinger's Cat in the IHTA 1984).

This case had a checkered history through the courts. There were two possible occasions of charge. The first was the transfer into the new pension fund; was that a transfer of value or was it exempt under Section 10 as a disposition not intended to confer a gratuitous benefit. The second was that she omitted to exercise a right by failing to draw her pension during her lifetime.

The First Tier Tribunal said that the transfer of the pension fund was not a transfer value. It was merely moving her pension entitlement to another pension fund in which she was equally entitled. However, the omission to exercise her right was a transfer of value and therefore chargeable.

The Upper Tribunal found that there was no transfer of value under Section 10 and there was no omission to exercise a right either. The Court of Appeal then decided exactly the opposite; both the transfer and the omission gave rise to a charge to tax.

The Supreme Court has now determined these issued definitively and concluded that the FTT was right – the transfer into the new pension fund was not a transfer of value, but her omission was a transfer of value and that is where the tax arose.

The Supreme Court explained that the omission by Mrs Staveley to exercise her right to her pension benefits meant that her sons' estates were increased - although section 3(3) does not require any particular person to benefit; just that the value of another person's estate is increased by the omission. The fact that there was an intervening discretion by the pension fund trustees to distribute the death benefits did not undermine this conclusion.

Although this is no longer a trap for pensioners, the implications of omitting to exercise a right is worryingly wide. One might say that Mrs Staveley's estate was not diminished by her omission. Her omission merely failed to increase her estate. That is not the same thing at all. But this is to overlook that she had a right to take the pension benefits and receive the money. The value of that right formed part of her estate and that right ceased to exist on her death. So, leaving aside any feline interference, her estate was therefore diminished by her omission.

This highlights the practical problems with this provision. If I withdraw from a lucrative piece of new work simply because I cannot be bothered to do it, knowing that another barrister will do it instead and receive the substantial fee, this would clearly be a transfer of value. There are many other examples. This does not seem right, but although this issue was not specifically considered by the Supreme Court, it is clearly going to be a difficult argument to overcome.

SDLT: Non Residents Surcharge

It seems clear that there is going to be another SDLT surcharge from 1st April 2021. Draft legislation has now been published. There will be an extra 2% on non resident purchasers of UK residential property which will take the top rate of SDLT up to 17% on properties over £1.5m.

This will apply to individuals, companies and trusts generally in the manner you would expect – except there are a few surprises.

For a start there is a special definition of *residence* for this purpose. Why on earth do we need another definition? HMRC are famous for saying (with no apparent irony) that the Statutory Residence Test is simple and easy to understand, so you would have thought they would have wanted to use that. But no.

The surcharge will apply to non residents but there is no definition of *non resident* for this purpose. An individual will be non resident unless he is UK resident - and he will be UK resident if he is present in the UK (at midnight) on at least 183 days for any continuous period of 365 days during the period starting 364 days before and ending 365 days after the transaction.

So it is no good just assuming that somebody is resident because he satisfies the Statutory Residence Test. He could quite easily be resident for all other tax purposes but non resident for the 2% surcharge. Talk about a trap for the unwary!

Where the purchaser is a trustee, and a beneficiary has a life interest, it is the non residence of the beneficiary which will apply to determine the liability to the additional surcharge. There is (of course) a different test of residence for the beneficiary. The residence of the beneficiary will be determined only by reference to whether he has been in the UK for 183 days in the 364 day period up to the date of the transaction.

The position for companies looks much simpler, their residence being determined by the normal rules under the Corporation Tax Acts – except that a UK resident close company controlled by not residents will be subject to the surcharge.

This 2% is in addition to all the other rates and surcharges. This would make it applicable to the first £500,000 (just like the 3% surcharge) except that the SDLT holiday up to £500,000 ends on 31st March 2021. At least that is the present intention. Watch this space I think.

Capital and Revenue Expenditure

Years ago, the question of whether an item of expenditure was capital or revenue cropped up all the time, giving rise to a variety of interesting arguments – but for some reason, such cases are now few and far between.

So it was a bit nostalgic to read the recent case of *Steadfast Manufacturing & Storage Ltd v HMRC TC 7770* which involved the cost of resurfacing the yard at the company's premises.

The time honoured question was whether this was a repair of the asset (which would be revenue) or the replacement of the asset (which would be capital). The company said that the works were the restoration of the surface which had become uneven and unstable. There was no increase in size nor any increase in the loadbearing capacity of the yard.

HMRC argued that the expenditure was capital on the grounds that it gave rise to an enduring advantage, because it would not have to be repaired again for years. That is an odd (and new) argument because every repair gives rise to the advantage that future repairs will be unnecessary for a period. Not surprisingly, the Tribunal did not think much of that.

Nor did HMRC fare better with the argument that the yard was improved because the builder's estimate described the works as a new car park. (Goodness me. How helpful would it be if the tax treatment of expenditure was determined by the wording on the suppliers invoice. You cannot imagine HMRC ever accepting such an argument if it were put forward by the taxpayer.) HMRC's acknowledgement that the new surface did not do anything more than the old surface, rather undermined their positon.

The Tribunal paraphrased the classic test in *Atherton v British Insulated and Helsby Cables Ltd [1925] 10 TC 155* that for the expenditure to be treated as capital, it had to bring into existence something new that has an enduring benefit to the business. This resurfacing did nothing more than bring the yard back to its original state and was therefore revenue expenditure.

Vans

The distinction between a car and a van is really important for tax purposes. Certainly it matters for the drivers who may be subject to income tax and NIC on a much higher benefit in kind, based on the scale applicable to cars. It is also important to the employer because of Class 1A NIC – and the possible loss of input tax for VAT.

The Court of Appeal has recently examined the position in <u>*HMRC v Coca Cola European Partners Great Britain Ltd [2019] UKUT 90.*</u>

Coca Cola provided vans to their technicians for use in their work and clearly thought that the vans did not give rise to the benefit in kind rules applicable to cars on the employees, nor to a Class 1A NIC charge on the company.

However, HMRC said that the vehicles were not "vans" but "cars" and therefore subject to the appropriate tax and NIC charges

The company supplied three types of vehicle, a Vivaro, a VW Kombi 1 and a VW Kombi 2. If you ever see one of those on the road they are obviously vans. However it is not enough to rely on the commonly understood meaning because there is a prescriptive statutory definition of a van in section 115 ITEPA 2003. The key element of the definition is:

> "a vehicle of a construction primarily suited for the conveyance of goods or burden of any description"

The Tribunals held that the Vivaro was a van satisfying section 115 but the Kombi vehicles were not. It does not really matter why because the Court of Appeal said their reasoning was flawed and that none of the vans were within section 115.

The Court of Appeal explained that it is not the use of the vehicle which is important; it is the construction of the vehicle - and whether the construction is primarily suited for the conveyance of goods. Primarily did not just mean marginally more suitable – it meant that the vehicle was constructed first and foremost as a goods vehicle. The Court acknowledged that a multi-purpose vehicle may have no primary suitability – which would of course prevent it from falling within section 115.

The tax penalty for selecting the wrong van is huge for the company and the employees – and I guess the sales of a multi-purpose vans will probably plunge; it is difficult to see how they can qualify under this test.

Goodness knows what the van drivers will say when they get an increased tax demand (which will be significant because these vehicles cost north of £30,000). Actually, I have a very good idea what they will say. !$@XX!?! and *!X%&$*

Maybe they will have an opportunity to express their view to the Supreme Court.

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