UK Tax Bulletin

November 2021

Field Court Tax Chambers

FIELD COURT TAX CHAMBERS

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Latest Rates of Inflation and Interest

The following are the latest rates:

Current Rates	
Retail Price Index: October 2021 September 2021	312 308.6
Inflation Rate: October 2021 September 2021	6% 4.9%
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 7th 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

From 6th April 2020 2.25%

From 6th April 2021 2 %

Discovery Assessments

The clarity provided by the Supreme Court in *Tooth* regarding discovery assessments, confirming that they can never be regarded as stale, was certainly welcome because confusion exists regarding many other aspects of the legislation on discovery assessments.

One controversial area is the amount of information which has to be provided to HMRC for them to be sufficiently aware of the possibility of underpayment of tax. If the tax officer has had sufficient information, then his time limit for raising an assessment is severely curtailed. It all depends on the meaning of section 29(5) TMA 1970.

This sounds a straightforward matter of judgment – but it is complicated by the fact that it is not HMRC which has to be provided with the information; it is a hypothetical tax officer (with various assumed characteristics). And it is this hypothetical person who needs to be sufficiently aware – or at least to be reasonably expected to be sufficiently aware - which is obviously impossible. So the whole exercise has no reality – it is all notional. No wonder it causes a few problems.

The issue was examined in the recent case of *Good v HMRC [2021] UK UT 0281*, where the Upper Tribunal had occasion to consider section 29(5) TMA 1970. The precise words of Section 29(5) are important as they provide a condition for the validity of the issue of a discovery assessment:

> "The officer could not have been reasonably expected on the basis of the information made available to him before that time to be aware of the situation mentioned in sub-section 1 above". (*That is to say that there had been an insufficiency*).

This test is supplemented by sub-section 6(d) which includes the following:

> "It is information the existence of which and the relevance of which as regards the situation mentioned in sub-section 1 above could reasonably be expected to be **inferred** by an officer of the Board from information falling within paragraphs (a) to (c) above or are notified in writing by the taxpayer to an officer of the Board".

I have highlighted the reference to "inferred" for reasons which will become clear.

This ability to infer was considered by the Upper Tribunal in HMRC v Charlton [2012] UK UT 770 where the taxpayer submitted a form AAG1 setting out the detailed arrangements for a tax scheme. The Upper Tribunal said:

> "We are, however, in no doubt that, first, the existence of the form AAG1 could reasonably have been expected to have been inferred by the hypothetical officer and secondly, that the physical separation of the SRN number [the DOTAS scheme reference number] from other relevant entries on the tax return would not have prevented an officer from making the necessary link between them so as reasonably to infer the relevance of the form AAG1 to the insufficiency….
>
> The circumstances of the form AAG1 in our view make it reasonable for its existence and relevance to be inferred…..
>
> In our view, the form AAG1 is just the sort of information the availability and relevance of which might reasonably be inferred from the inclusion of the SRN in a return which also discloses tax effects consistent with tax planning".

These extracts (there are more) make a pretty strong statement of the position when a form AAG1 is submitted. It is therefore rather a surprise that the FTT in *Good* decided that a completed AAG1 form and the relevant DOTAS scheme reference number which had been disclosed on the tax returns was not enough for the officer to reasonably aware of the insufficiency.

It is even more surprising that the Upper Tribunal concluded that the FTT made no error of law in this approach, nor did it misdirect itself as to the applicable principles.

The taxpayer argued that submission of the form AAG1 made it reasonable for the information and its relevance to be inferred by the officer (exactly as had been held in *Charlton*) but the Upper Tribunal rejected this argument.

It seems that the inferences permitted by Section 29(6) and the significance of a form AAG1 may not as strong as suggested in *Charlton* and maybe we have a new yardstick. Or maybe we don't.

Cryptocurrency

For somebody who knows nothing about cryptocurrency I seem to be saying a lot about it in these bulletins. I have noticed that HMRC are apparently not sending out their nudge letters about cryptocurrency gains as planned, on the grounds that the message might get confused amid discussion on the contentious elements.

However, they wish to make it clear that all gains made by resident non dom taxpayer are still subject to capital gains tax.

I deduce that the grounds for this are that HMRC say the remittance basis does not apply because the cryptocurrency is situated in the UK because the owner is UK resident. Well, maybe. That is their published view. However, this is not necessarily the case and I mentioned last month that the CIOT have published a detailed paper explaining why not.

This is going to be interesting, however it plays out.

Business Asset Disposal Relief

One of the notorious uncertainties with Business Asset Disposal Relief (the relief formerly known as Prince) is the part of section 165A(3) TCGA 1992 which defines a trading company as:

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

Section 165A(4) goes on to explain what trading activities mean, but there is no further assistance about what is meant by "to a substantial extent".

The view of HMRC is set out in the capital gains tax manual at paragraph 64090 where they say that "substantial in this context means more than 20%".

There is no authority for this threshold of 20% and views range from it meaning "mainly" down to something just above insubstantial. Indeed, no assistance can be derived from tax legislation either. For the Substantial Shareholding Exemption it means 10%; for Social Enterprise Relief it means 30%; for SDLT substantial performance it is "most" (and so on). So where does 20% come from. I guess it comes from what HMRC say three times (or even once) is true.

The HMRC guidance goes on to consider various indicators such as the income from non-trading activities; the company's assets, and the expenses or time spent by employees in the different activities. And, on the basis of the decision in *Farmer v HMRC SPC 216*, HMRC suggests that you weigh up the relevance of each indicator in the context of the individual case and judge the matter in the round.

That sounds sensible, but it is difficult to see how *Farmer* can really be any kind of authority. It was an inheritance tax case about a completely different relief in a completely different statute. So we are a bit on our own in determining the extent to which non-trading activities are substantial – and, indeed, what is meant by an activity at all.

It is therefore of great interest to read the Upper Tribunal case of *Allam v HMRC [2021] UKUT 0291* in which this very point was examined.

The Upper Tribunal explained that we can pretty much forget the suggestion of 20%. They said: "it is not appropriate to apply any sort of numerical threshold as suggested by HMRC's guidance".

That is very welcome because the matter can now be dealt with on its merits and not on the basis of an arbitrary HMRC's threshold.

The Upper Tribunal were not any more supportive of the use of the tests set out in the guidance. They acknowledged that the test for the relief is qualitative and quantitative, and that it is necessary to look at both the nature of the activities and to measure the extent of those activities looked at as a whole.

The Upper Tribunal mentioned that the FTT did not refer to *Farmer* in terms and thought they were right not to do so. They said it is not helpful to put a gloss on the words of the statute, explaining the position as follows:

> "What is substantial in the context of trading and non-trading activities should be given its ordinary and natural meaning. Application of the test involves identifying the trading and non-trading activities and then considering how best to measure the non-trading activities to see whether they are substantial in the context of the company's activities as a whole."

This seems to be entirely consistent with the approach taken in *Farmer*. Maybe the Upper Tribunal felt we should not be trying to apply an inheritance tax test to this capital gains tax relief, and it ought to have its own test – even if it turns out to be similar.

There was a lot of discussion about what represents *activities*. The Upper Tribunal said that whatever a company does represents its activities, and they may be of an investment nature or a trading nature. The income and asset position of the company are relevant and so are the expenses and time incurred by the directors and employees (which rather mirrors the HMRC guidance) but one then has to stand back and look at the activities of the company as a whole and ask: "what is this company actually doing?".

Well yes – but that is not very helpful because the answer you will always get is that the company is doing some trading and some investing. The issue is whether the investing activity is substantial. Does that mean wholly or mainly, so that as long as the investing does not predominate you get the relief; if not, is there some lower threshold. And if so, what is it?

Frustratingly we did not get any guidance about what was substantial. Clearly the 20% test does not apply – but what does? We have lots of guidance about the things that we might consider, but not the weight that we might give to them.

However, at least this is a step forward.

Transactions in Securities

The case of _Allam_ also involved a discussion regarding the Transactions in Securities legislation in sections 682 - 713 ITA 2007. This too gives rise to an interesting point.

If we consider the basic building blocks of the Transactions in Securities legislation, the paradigm case of *CIR v Cleary HL 1967, 44 TC 399* is always the starting point. A taxpayer sells shares in one of his companies to another of his companies at market value. Maybe he makes a capital gain – maybe he does not – but either way he gets money out of the company and at worst has a capital gain (rather than income tax on a dividend which would be the obvious way to extract the money).

This is the fiscal equivalent of the Holy Grail – and is where Transactions in Securities comes in.

Such a sale would represent a transaction in securities and the receipt of consideration which is not chargeable to income tax - and HMRC would have no hesitation in issuing a counteraction notice under section 698 effectively treating the consideration as if it were a dividend. I apologise, as this will all be very familiar.

Over the years, these concepts have become more and more sophisticated and a transaction in securities (with these pretty serious consequences) can emerge in the most subtle of circumstances.

However, all this will not apply unless "the main purpose or one of the main purposes of the transaction in securities or any of the transactions in securities is to obtain an income tax advantage". This test was central to the decision in _Allam_.

In Dr Allam's case, he had two companies and he sold one company to the other for £4.95 million. Did this give rise to an income tax advantage? Er, yes - it sure did. The FTT therefore gave detailed consideration to whether the obtaining of this tax advantage was one of the main purposes of the transaction. They concluded that it was not:

> "Dr Allam had a clear purpose for the transfer (to unite the companies under common ownership) and a clear purpose for his desire to receive the proceeds in cash (to fund his retirement). The latter was not a commercial reason. It was a personal reason but it was not a tax reason. The effect of the transaction was to realise the value of ADL and to use that value to support Dr Allam's desire for a fund for his retirement".

On appeal the Upper Tribunal said that the FTT was entitled to find that Dr Allam did not have as a main purpose the obtaining of a tax advantage and that their view could reasonably be entertained.

This reasoning and conclusion will no doubt be welcomed by taxpayers and anybody familiar with this subject will immediately see that this is very good news.

However, I can't help feeling that Dr Allam was rather fortunate. What Dr Allan was really saying is that he wanted the money. He said that he wanted the money to fund his retirement – but all that means is that he just wanted the money to spend. (This is hardly an unusual objective).

The judgment records that Dr Allam took great exception to the suggestion that the transaction had been motivated by a desire to obtain an income tax advantage. It seems that it did not occur to him that the money could have been taken as a dividend on which he would have paid a huge amount of income tax. Instead, he thought he would unite his companies and get the money that way – and it was just incidental (or perhaps accidental) that by doing that he enjoyed a huge tax advantage.

This decision (particularly as it was upheld by the Upper Tribunal) must give many people (and many advisers) increased hope of escaping the full force of the Transactions in Securities legislation on such grounds.

Research and Development Allowances

The recent case of *Quinn (London) Limited v HMRC TC/2020/1846* was concerned with a claim for enhanced relief for expenditure on in-house direct research and development. The company carried on a trade and incurred what would be qualifying expenditure and sought a deduction in calculating their profits for corporation tax purposes.

One of the conditions for the enhanced relief is that the expenditure is not subsidised within the meaning of Section 1138(1)(c) CTA 2009. This denies relief for expenditure:

> "To the extent that it is otherwise met directly or indirectly by a person other than the company".

It clearly makes sense that if you are receiving a subsidy covering all or part of the costs, you should not be entitled to all the relief. However, in this case the arguments were a little more extreme.

The company was a construction company which undertook projects for a variety of customers including local authorities, property developers, hospital trusts and housing associations. Each of these projects stimulated new technological knowledge or capability which the company was able to use in doing their work more efficiently. The company undertook their refurbishment or construction work and were paid their fees for the projects.

HMRC suggested that when they were paid, those payments covered the research and development costs and therefore were disqualified for relief because the costs had been met by another person which was prohibited by 1138(1)(c).

The FTT rejected this argument. It must be right that any profitable company which incurs research and development expenditure must receive by way of sales or trading income, money which covers the cost of the expenditure. Indeed, even if the company was unprofitable, and the expenditure needed to be funded by loans from the bank, the expenditure would still not be met by the company but by a third party.

This argument was developed in highly complex terms in a lengthy judgment, but must surely have this simplicity at its core. Such an interpretation would mean that it would be impossible for any company to obtain relief in almost every imaginable circumstance. Can HMRC really think it is right to argue that Parliament intended to introduce a relief which nobody would be able to claim?

It is a little resonant of the argument (which has also been raised elsewhere), that if you invest in a favoured investment – such as shares in a company qualifying for the EIS which gives you income tax and CGT reliefs - then you are disqualified from the relief because the issue of the shares is an arrangement where one of the main purposes is the avoidance of tax.

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