UK Tax Bulletin

June 2022

Field Court Tax Chambers

FIELD COURT TAX CHAMBERS

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Latest Rates of Inflation and Interest

The following are the latest rates: June 2022

Current Rates	
Retail Price Index: April 2022 May 2022	334.6 337.1
Inflation Rate: April 2022 May 2022	11.1% 11.7%
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 3.75% from 5th July 2022.

There is one exception: Quarterly instalments of corporation tax bear interest at only 2.25% from 27th June 2022.

Repayment supplement

Interest on overpaid tax has been 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 %

Statutory Residence Test

It's all go with the Statutory Residence Test. Last month we had an analysis by the FTT of the rules relating to exceptional days – and this month we have another decision relating to the operation of the *arriver* and *leaver* rules.

The case of *Ernest Batten v HMRC TC 8524* concerned the application of the new test. (The SRT is hardly a new test having come into force in 2013 but unfortunately the old rules are not going away.) I would recommend that you sit down, preferably somewhere padded.

Mr Batten's tax residence for 2014/15 needed to be determined under the Statutory Residence Test and depended on the number of days he spent in the UK and the number of his UK. Ties. He had two UK ties and spent 116 days in the UK.

The number of days he was allowed in the UK with two ties depended on whether he was an *arriver* or a *leaver*. These are shorthand terms for a person who was resident in any of the previous 3 years (a *leaver*) or who was not resident in any of the previous 3 years (an *arriver*).

If he was a *leaver* with two ties he was resident if he spent more than 90 days in the UK in the year; if he was an *arriver* he was allowed 120 days.

HMRC said he was a *leaver* – and as he was in the UK for more than 90 days he was resident for 2014/15. Mr Batten said he was an *arriver* and therefore not resident because he was in the UK for less than 120 days.

The question was therefore whether he was resident for any of the previous three years. It was agreed that he was not resident for the years 2011/12 and 2013/14 -so what mattered was whether he was resident for the year 2012/13.

Everybody agreed that under the Statutory Residence Test he would not have been resident for 2012/13. Sounds good.

Not so fast kimo sabe. 2012/13 was the year before the introduction of the SRT so the new rules were not relevant; his residence for that year had to be determined by reference to the old rules. So we have to go back to all the old stuff that caused so much difficulty like IR20 (of blessed memory) and the cases of Grace, Glyn, Gaines-Cooper, Combe, Levene, Reed v Clark an so on, needed to be examined to determine Mr Batten's residence for 2012/13.

Anybody familiar with IR20 will remember that it was overtaken by the interminable litigation – each case, of course, being specific to its own facts so that nobody, however knowledgeable, could come to confident conclusion about a person's tax residence. To that extent, the SRT brought some welcome clarity to the situation. But unfortunately, not for Mr Batten.

The FTT analysed Mr Batten's circumstances for the year 2012/13 and concluded that he was resident for that year. (Don't ask). That made him a *leaver* and entitled to only 90 days in the UK for 2014/15. He was therefore resident under the SRT rules for 2014/15

The Court recognised the unsatisfactory nature of this decision particularly because the application of the SRT to 2012/13 would have produced a different result. The judge said:

> "We recognise that the result is untidy. Mr Batten was non-resident in 2010/11 and 2011/12, UK resident in 2012/13, non-resident in 2013/14 and resident in 2014/15."

Untidy it certainly is. There are other words which could be used. Can you imagine what a client is going to say when this is explained to them? It just brings the subject (and by necessary implication, HMRC) into disrepute. That is really undesirable. The judgment may be entirely correct on the law, but actually that makes it worse. You mean they really intended it to be like this!

Nobody wants unnecessary tinkering but it would not be a bad idea if HMRC were to take notice of the two recent decisions relating to the SRT and make some early and sensible revisions to correct the obvious and justified criticisms.

CGT: Main Residence Exemption

This is another subject which is fraught with difficulties of interpretation bearing in mind the large number of conflicting decisions. However, now and again a genuinely interesting point of interpretation (rather than different views on the facts) comes to be determined.

In the case of *Gerald and Sarah Lee v HMRC TC 8502,* the taxpayers sold a property and claimed that the gain was exempt on the grounds that it was the disposal of their only or main residence.

Everybody knows that the CGT exemption applies broadly to a gain made on the disposal of a property which has been the taxpayers' main residence together with the garden or grounds: section 222 TCGA 1992

What happened in this case was that the taxpayers bought a house (and land) in October 2010. The house was demolished and a new house was built. The new house was completed on 15th March 2013 and they took up residence in the new house four days later enjoying the house and its garden and grounds. They later sold the house and made a capital gain.

The question for the FTT was whether their period of ownership should start when the newly built house was completed or whether it should start from the original acquisition of the land.

Their argument was that section 222 refers to the period of ownership of the dwelling house and because they lived in the house for all but four days of the house's existence as a dwelling house they were entitled to the relief for the whole gain.

HMRC said that the land had been purchased in October 2010 and they did not occupy the house until March 2013. So during that period it was not their main residence and the exemption could not apply for that period. The taxpayers acquired, owned and disposed of a single asset being an interest in land (on which there was a dwelling house) but there was only ever a single asset consisting of the land and any buildings which may be erected on it.

However, the FTT did not agree that the reference to dwelling house in section 222 should include the land. Although land includes the dwelling house, it did not mean that dwelling house should also include the land. The FTT mentioned the case of *Henke v HMRC [2006] STC (SCD) 561* where the Special Commissioners found in a similar case, that the period of ownership started when the land was purchased. The judge did not attempt to distinguish the case; she merely said that she was not bound by it.

In essence, the conclusion of the Tribunal was that although a single asset was purchased and sold, the legislation works to calculate the gain and then to determine whether, and if so how much, relief applies to that gain.

Accordingly, following the arguments of the taxpayer, they occupied the dwelling house for virtually the whole of the time since it existed and the exemption was therefore allowed in full.

No explicit reference was made to section 224(2) which provides for the possibility of an apportionment as follows:

> "If at any time in the period of ownership there is a change in what is occupied as the individual's residence, whether on account of a reconstruction or conversion of a building or for any other reason, … the relief given by section 223 and 223B may be adjusted in a manner which is just and reasonable".

However, on the basis that there was no change in what was actually occupied as a residence, this would not apply. But maybe there was such a change because in the first three years of their period of ownership, they were residing somewhere else - although that argument does not work if you regard the period of ownership as starting only when they moved in.

It is difficult to avoid the conclusion that if I buy a piece of land and decide to build a house on it for my own occupation as a main residence, I can take as many years as I like to build the house and the whole gain will be exempt on its ultimate disposal. An interesting opportunity perhaps.

Information Notices

Last month I mentioned the decision of Hackmey v HMRC TC 8487 where the Court said it was common ground that HMRC has the burden of proof in showing that the requirements of an information notice under Schedule 36 are satisfied. This had been controversial because HMRC had strongly and successfully argued in the past that the burden of proof was on the taxpayer.

We now have the case of *One Call Insurance Services Ltd v HMRC TC 8509* in which it is clearly stated that:

> "The burden of proof rests on HMRC to show that the notice was validly issued and that the requirement set out in Schedule 36 for its issue were met. HMRC accept that the burden of proof to show that the items sought by them are reasonably required for checking One Call's tax position rests with them".

It now seems quite clear that despite the earlier decisions to the contrary, this point is now settled. Indeed, in the decision in *Jenner v HMRC TC 8528* released only a few days ago, HMRC made a formal submission which was accepted as correct by the FTT, that the burden of proof on this matter rested with HMRC.

One Call Insurance Services also dealt with the interesting subject of what is meant by documents being in a person's possession or power. This is important because Schedule 36(18) specifically provides that:

> "An information notice only requires a person to produce a document if it is the person's power or possession."

It is not enough to say that you do not possess the relevant documents if you have power to obtain them. The Upper Tribunal has held that "power" in this context is not merely the legal power but the de facto power - and where documents are in the possession of third parties such as trustees, the taxpayer must make a serious attempt to obtain the documents from the third parties.

This is a little controversial because if a person does not have an enforceable right or power to obtain a document, he can be as serious as he likes in attempting to obtain it but that does not give him the "power". He may be able to threaten or coerce the other person but that is hardly an appropriate basis for satisfying a legal test. If I have a gun (or a bigger gun than you) does that mean I have power to obtain all your possessions? Of course it does – but equally obviously it cannot be the sort of power envisaged by Schedule 36.

Discovery Assessments

The case of *Johnson v HMRC TC 8483* might cause a bit of alarm. (Not that Johnson!)

It concerned a discovery assessment issued under section 29(4) TMA 19070 on the basis that the relevant insufficiency of tax was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf.

The taxpayer had received a compensation payment from Nat West in respect of a financial hedging product. HMRC considered that such receipts were taxable and said so clearly in guidance published on their website. The taxpayer's adviser was aware of the HMRC guidance but felt that there was ambiguity regarding the taxability of the particular receipt – so he made a disclosure in the white space explaining the receipt.

A full disclosure in the white space provides a defence to a discovery assessment by reason of section 29(5) on the grounds that the tax officer could reasonably be expected to be aware of the insufficiency on the basis of information provided by the taxpayer. Yes, OK …. but …. this defence applies to section 29(5) – it does not apply to discovery assessments made under section 29(4) on the basis of careless conduct.

So the issue was all about whether or not the adviser was careless.

The FTT held that the adviser was careless. He knew about the HMRC guidance and should have included the receipt as taxable business income; he was careless not to have done so.

This seems a bit tough. He was careless just because he did not follow HMRC guidance but put the details in the white space! The FTT accepted that there may have been some ambiguity but said that an experienced tax adviser would have thought it pretty likely that the receipt would be taxable. This is a new test – and it is not clear why a new test is required having regard to the well established test for carelessness – and indeed the view set out in the HMRC Compliance Manual which says that a person would be careless:

> "….if, unintentionally, they omitted to do that which a prudent and reasonable person would have done, or did that which a person taking reasonable care would not have done. (Baron Alderman, from the 1856 case of Blyth v Birmingham Waterworks Co)"

In the context of a tax return, the test was expressed in *Anderson (Deceased) v HMRC TC 206* (and confirmed in other cases) to be:

> "what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done."

It is not clear whether the FTT view that an experienced adviser would "have thought it was pretty likely" that the receipt would be taxable corresponds to this test - but maybe it does.

So what protection does a white space disclosure provide? None it seems. If the conclusion from the information in the white space is correct then you do not need to make the disclosure at all – and if it is wrong, you must have been careless. Which puts you in the same position as if you did not make any disclosure at all. Can this really be right?

Shares Held on Trust

It is occasionally suggested that shares – or other assets – do not belong to the person in whose name they are registered (the legal owner) but that they are held by the legal owner for the benefit of somebody else, who is the beneficial owner. Sometimes this is very important for tax purposes because in most cases it is the beneficial owner who is the person liable to tax (or eligible for reliefs) on the acquisition or disposal of the shares.

I do not propose to get into a detailed analysis of the trust law issues but merely note that the point arose in the recent case of *Kavanagh v HMRC TC 8500*. Mr

Kavanagh wished to claim Entrepreneurs Relief – now tediously called Business Assets Disposal Relief – on the disposal of some shares but unfortunately he was the registered owner of less than 5% of the shares which was necessary to qualify for the relief. His shareholding was tantalisingly short – at 4.99729% - which for most practical purpose would of course be rounded to 5%.

Mr Kavanagh explained that all the other shareholders either believed, intended or expected him to have 5% and that they held the balance of shares making up his holding to 5% on trust for him as beneficial owner. Unfortunately there was insufficient evidence to show that he was the beneficial owner of any of the shares held by the other shareholders or that any express, constructive or resulting trust existed.

The reason I mention all this is merely to highlight the fact that the Tribunal Judge Richard Chapman QC set out in considerable detail the principles involved in considering the existence of an express, constructive or resulting trust – which will be very helpful the next time this situation arises.

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Important Note