UK Tax Bulletin

September 2023

Field Court Tax Chambers

Contents

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Latest Rates of Inflation and Interest

The following are the latest rates: September 2023

Current Rates	
Retail Price Index: July 2023	374.2
August 2023	376.6
Inflation Rate: July 2023	9%
August 2023	9.1%
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 7.75% which applies from 22nd August 2023.

There is one exception: Quarterly instalments of corporation tax bear interest at 6.25% from 14th August 2023; interest on overpaid instalments will be paid at 5%

Repayment supplement

Interest on overpaid tax is paid at Bank base rate minus 1% which gives a rate of 4.25% from 22nd August 2023.

Official rate of interest

From 6th April 2021 2%

From 6th April 2023 2.25%

Home Loan Schemes

Home loan schemes have been the subject of challenge by HMRC for ages, but the recent decision by the highly respected judge Beare provides the most definitive analysis yet on the numerous issues: *Elborne v HMRC TC 8863.*

In 2003, Mrs Elborne transferred her private residence to a trust in which she had a life interest, in consideration of a loan note of £1.8m. She then settled the loan note on a second trust for her children but from which she was totally excluded. She continued to live in the house until she died, more than seven years later. On her death the net value of the house (reduced by the loan) formed part of her estate by reason of section 49 IHTA 1984, but the loan note did not. She did not have a reservation of benefit; the settling of the loan had been a potentially exempt transfer which had become completely exempt after seven years.

Well, that was the plan. Unfortunately, what actually happened did not correspond all that much with the documentation, and there were a few problems with the documents too. This gave rise to extensive arguments from HMRC (as one might expect) but the Tribunal was content to overlook these implementation deficiencies and to focus on the overall plan.

The Tribunal held that there was no reservation of benefit and that the arrangements were all valid. They rejected pretty much all the arguments of HMRC…. except one. To achieve the intended result, it was obviously necessary for the loan to be deductible from the value of the property in the first trust – otherwise the whole plan would be a waste of time because the full value of the house at the date of death would remain in Mrs Elborne's estate.

Unfortunately, the FTT found that the loan was not deductible. For the same reasons as in *Pride v HMRC TC 8876,* the FTT considered that the indebtedness under the loan note was a liability created by (or treated as being created by) Mrs Elborne and therefore fell within section 103 Finance Act 1986 which denies an IHT deduction for loans to the extent that the consideration for the loan consists of property derived from the deceased. End of story – and of an attractive plan.

HMRC had another argument up their sleeve – no doubt as a frightener to others who may be pursuing a similar plan – that Mrs Elborne had a reservation of benefit in the loan note, and the loan note should therefore form part of her estate.

So, not only would the full amount of the property be taxable in Mrs Elborne's estate (without any deduction for the loan because of section 103) but the loan itself should be regarded as an asset of her estate as well – meaning that the overall effect of the plan would not be to decrease her estate by £1.8m but to increase her estate by £1.8m. That possibility would probably be a bit of a downer for those of a nervous disposition. However, the FTT dismissed this argument, disagreeing with the analysis – but you never know what might happen on appeal.

Things have moved on of course since 2003 – in particular the changes in 2006 which mean that if a gift of a property were to be made to a life interest trust now, it would be a chargeable lifetime transfer, and so would the gift of the loan note into the children's trust. In addition, the POAT legislation (Pre Owned Assets Tax) could well apply and to make it worse, SDLT would now apply to the transfer of the property into the trust.

Tax Clearances

There is no automatic or universal right to obtain a clearance from HMRC regarding the tax treatment of a particular transaction; this only applies where there is a statutory or established right. This is a pity because it would be of immense value to the taxpaying public - but I suppose we can well understand the cost constraints.

One consequence of this situation is that where the law provides the opportunity to seek a clearance from HMRC that they do not consider the transaction to be part of a scheme or arrangement the main purpose of which is the avoidance of tax, the opportunity is rarely ignored. A clearance will inevitably be sought, not only as a precaution for the taxpayer but also for the advisers, even if it is only a formality.

One such clearance opportunity exists with a share for share exchange under section 135 TCGA 1992 because this relief will not be allowed:

> "unless the exchange or scheme of reconstruction in question is effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is

avoidance of liability to capital gains tax or corporation tax." Section 137

Section 138 provides an opportunity to seek a clearance from HMRC that section 137 does not apply, in other words that the arrangements do not have a main purpose of avoiding capital gains tax or corporation tax.

This will all be familiar stuff. It may therefore be of interest to read the recent (and comforting) decision in *Wilkinson v HMRC TC 8887*.

In this case, a company was being sold and the Wilkinson family were going to receive £130m for their shares, the consideration being a mixture of cash and loan notes. Immediately before the sale the parents transferred some shares to their daughters to enable them to benefit from entrepreneurs' relief. This resulted in a tax saving of £3m. This was not an accident; it was pursuant to specific tax advice from expert advisers.

HMRC argued that these transfers were part of a scheme or arrangement for the disposal of the shares in the company the main purpose of which was to avoid capital gains tax. Part of the arrangements were admittedly tax motivated, and this infected the whole deal, thereby disallowing the deferral relief in section 135 – which naturally scuppered the entrepreneurs relief for the daughters.

The FTT held that while the part of the arrangements relating to the daughters' shares was undertaken for a tax purpose, it was not a *main* purpose. The sale was going ahead anyway and these arrangement with the daughters was an optional extra or bonus - a minor saving in the context of the sale overall and it would have been abandoned if it had caused a problem with the purchasers.

It may be hoped that it is now settled that if one (non crucial) element of a transaction has a tax motivation that will not undermine the whole transaction. I would suggest that this must be right because otherwise, a decision to fund a purchase of a company by debt rather than equity (an alternative specifically envisaged and provided for in the legislation) could be enough to deny the application of section 135.

An interesting point here is that section 137 refers only to capital gains tax or corporation tax so that arrangements undertaken for the purpose of saving of IHT or SDLT will not prevent the application of section 135 to a share exchange or reconstructions. Other TAAR provisions are not so specific, referring to just "tax" which makes life much more difficult.

Expenditure Incurred

My eye recently fell upon the case of *HMRC v Perenco UK Ltd [2023] UKUT 0169* which was concerned with the Oil Taxation Act 1975. Why on earth? ….. you might well ask.

Well, yes. I don't know much about Oil Taxation (knowing that it exists is about as far as I go) but it is a *tax* – so you never know what you might find in a decision of the Upper Tribunal on the subject. Rarely worth the effort perhaps. However, the recent case of *Perenco* did contain an interesting element - once you get past the virtually incomprehensible stuff about oil fields and similar stuff. I will move on swiftly because if I say any more about that, this Bulletin will be destined for the bin without further ado.

A familiar issue arose, which is whether tax relief can be claimed for expenditure that has been met by somebody else. Obviously not, because then you would not be incurring the expenditure. Examples would be a subsidy of some description or if expenditure is specifically reimbursed by a third party.

HMRC argued (which they have done before) that expenditure should be regarded as having been met by another person - and therefore not been incurred by the taxpayer - where the other person puts them in funds to meet the expenditure.

This argument went much too far and was rejected by the FTT. What it would mean is that when a customer buys something from a trader, he puts the trader in funds to meet his expenditure - thereby disqualifying every item of his expenditure from being incurred for tax purposes.

HMRC did acknowledge that this would not be a correct interpretation – which is helpful, but it does not explain why they argued the point, especially as it has been argued unsuccessfully before.

IHT 10 year charge

I have come across an interesting point on the 10 year inheritance tax charge which applies to discretionary will trusts.

In earlier Tax Bulletins I have made reference to trusts established by foreign domicile persons. The settled property will be excluded property to the extent that the property is situated outside the UK on the occasion of charge to IHT: section 48(3) IHTA 1984

If the settlor becomes UK domiciled or deemed domiciled, the settled property will still be excluded property because the settlor was not domiciled when the settlement was made. But what if he then adds foreign property to the trust after becoming UK domiciled? Does that become excluded property because the settlement was made when he was not domiciled. (It would give rise to an entry charge, but that is a different matter).

This was a matter of serious debate (in the sense that HMRC said this was the making of a new settlement, and everybody else said it wasn't). Anyway, the matter was resolved by an amendment in the Finance Act 2020 to say that the settled property will only be excluded property under section 48(3) if the settlor was not domiciled when the property became comprised in the settlement. And this is retrospective – bringing the interesting argument (and opportunity) to an end.

An important issue relates to the date when the 10 year charge arises, particularly where the trust is established by deed of variation following a death. The commencement date of the trust for all relevant purposes is the date of death. That is clear from section 142(1) IHTA 1984. However, when computing the 10 year a difficulty arises.

Section 83 states that:

"Property which becomes comprised in a settlement in pursuance of a will or intestacy shall for the purposes of this chapter be taken to have become comprised in it on the death of the testator or intestate."

Property which is settled by deed of variation is not comprised in the settlement in pursuance of a will or intestacy. It is not in fact comprised in the settlement until the date of the deed of variation which may be nearly 2 years after the date of death.

It would therefore follow that the rate of tax payable on the tenth anniversary should be reduced because the property did not actually become comprised in the settlement until nearly 2 years later. If it was not comprised in the settlement throughout the period of 10 years ending with the tenth anniversary, then section 66(2) IHTA 1984 reduces the rate of tax by one-fortieth for each of the successive quarters which expired before the property became relevant property. Simples.

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