UK Tax Bulletin

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Introduction

Current Rates: .... Latest rates of inflation and interest

Stamp Duty Land Tax:.. More details about the 3% surcharge

Sporting Testimonials:... Testimonials to be brought into charge to tax

Mansworth v Jelley Losses: .... The HMRC guidance provides a legitimate expectation

EIS relief:.. Loss of relief from preferential rights

Reasonable Excuse:... Another success with insufficient funds

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Latest Rates of Inflation and Interest

The following are the current rates at December 2015

Current Rates	December 2015
Retail Price Index: November 2015	259.8
Inflation Rate: November 2015	1.1%
Indexation factor from March 1982:	
to October 2015	2.267
to November 2015	2.270

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%.

There is one exception: Quarterly instalments of corporation tax bear interest at only 1.5%.

Repayment supplement

Interest on all overpaid tax is payable at the same rate.

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 6 April 2014: 4%

To 6 April 2015: 3.25%

From 6 April 2015: 3%

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Stamp Duty Land Tax

The proposals regarding Stamp Duty Land Tax in the Autumn Statement relating to buy to let properties and second homes have been supplemented by further announcements.

The 3% increase in the rates of SDLT across the board for these purposes (although not for purchases under £40,000) will apply to all contracts entered into on or after 26 November 2015 where completion takes place after 1 April 2016.

That is clear enough but there are some transitional rules – although they do not seem to add anything. For example, the new rates will not apply to contracts entered into before 26 November or where completion takes place before 1 April 2016. Well yes. The only distinction I can identify is the acknowledgement by HMRC that completion will be treated as including substantial performance.

It is also confirmed that these new rates will apply to foreign investors and to anybody who owns another property anywhere in the world if they purchase an additional property in the UK.

This seems to be rather a complex idea. A foreign person buying property in the UK ought to be able to understand which rate of SDLT will apply to his purchase. He now needs to be interrogated regarding his property holdings in other countries. What if he lives in rented accommodation in another country? And what if there are other properties in a trust or a company which he uses – or lets.

Given that an overseas purchaser by definition lives abroad, he must live somewhere so presumably unless he is homeless, he will be liable to the 3% surcharge. Do we not feel that Mr Osborne is getting a little carried away here?

Some of these questions have been answered by the consultation document published by HM Treasury on 28 December. This makes it clear that the higher rate will not apply where the individual purchaser only owns one residential property, irrespective of the intended use of the property. In addition, where an individual is replacing his main residence then the higher rate will not apply.

HMRC seem to acknowledge that a person who lives in rented accommodation and buys a residential property as an investment, he will not have to pay the higher rate – but I wonder what "rented accommodation" means. A tenancy, a short lease, a long lease?

If the individual has sold his main residence within 18 months of the purchase of a new property which is going to be his new main residence, that will be regarded as the replacement of a main residence and the higher rate of SDLT will not apply. This will be the position irrespective of the number of other properties the individual may have.

HMRC seem to take the view that identifying a main residence is quite simple: "In most cases the position will be clear". I think this must be some kind of code. Either that, or the person drafting the consultation document is not up to date with his reading of tax cases. In reality, the unbelievably contradictory case law on the subject means this is going to be a seriously difficult problem. To make matters worse, there will be no right to elect which residence is the main residence, so the main residence for SDLT purposes may differ from that for capital gains tax.

The new rules only apply to purchases of residential property but there is an exemption where 6 or more residential properties are bought in a single transaction. So buying one buy to let property is a bad thing and needs to be penalized – but buying 7 is a good thing and deserves to be rewarded. Um. I think I may need a lie down.

The treatment of trusts is particularly troublesome. In essence, the idea is that if a beneficiary has an interest in possession in the property, he will be liable to the SDLT at the higher rates. That will be popular, where is he supposed to get the money from? One is tempted to have some fun by appointing George Osborne a beneficiary and giving him a temporary interest in possession in the property for a few weeks so that he is liable to the SDLT – but we would not want to be silly.

Where there is no interest in possession in the property the trustees will be liable to the higher rates – apparently whatever the circumstances.

It may be remembered that stamp duty used to be charged on the slab basis – if you cross the threshold you paid the higher rate on the whole of the consideration. HMRC acknowledged the unfairness of this approach and now impose stamp duty on the slice basis so that you only pay the increased rates on the consideration over the relevant limits. So, what happens with the £40,000 exemption from this 3% rate? We go back to the old system. Transactions under £40,000 are not subject to the higher rate of SDLT – but anything over £40,000 is chargeable on the full amount. So a purchase for £41,000 will cost stamp duty of £1,230. However, I daresay this is only one of the screaming anomalies which will be fixed during the consultation process.

Sporting Testimonials

HMRC have now published the draft legislation relating to their proposal to tax receipts of sportsmen from sporting testimonials. An intention to bring such receipts into charge to tax was floated earlier in the year and it is proposed that it will come into effect in April 2017.

It has been the law for decades that where a testimonial or benefit is organised to demonstrate affection and regard for the personal qualities of the sportsman, the proceeds are not received from the employment and are not taxable as earnings. HMRC suggest that this long established principle was overturned by Part 7A of ITEPA 2003 but they have continued to treat the receipts as tax free by concession. They also suggest that the benefits code which was introduced in 1948 also caused these receipts to be taxable so they have actually been operating a concession for the last 68 years. I am not so sure about that. The decision of the House of Lords in *Reed v Seymour 11 TC 625* in 1927 has withstood many challenges and HMRC have never succeeded in establishing that it was wrong. Indeed the various challenges have merely reinforced the position that unless the payments are remuneration for services, for example where the entitlement arises from the contract of employment, they are not earnings and not taxable.

Anyway, whether HMRC have been operating under the law, or by concession, in their treatment of sporting testimonials does not really matter because they are not proposing any retrospective changes. They are merely saying that new legislation will bring such payments into charge to tax after 5 April 2017. Similar legislation will be introduced to bring such payments into charge to National Insurance Contributions - although I wonder who is going to be liable for the secondary (employers) NIC.

HMRC explain the general idea that income arising from a non contractual sporting testimonial or benefit for an employed sportsman will be liable to income tax. Referring to such receipts as "income" would seem to pre-judge the issue - but the draft legislation contains no reference to income, referring only to payments made to the sportsman for the benefit of himself or his family or household.

However, payments made to the sportsman will not be taxable where the person controlling the collection and disbursement of the donations is an individual unconnected with the sportsman or the employer. This would seem to correspond to the established acknowledgment that money raised by collections from the general public are not taxable.

There is a glimmer of relief here. There will be a limited exemption (a lifetime limit) for the first £50,000 of sporting testimonial payments. I suppose we should be grateful.

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Mansworth v Jelley Losses

This just keeps on going.

It may be remembered that HMRC have been changing their mind about the implications of this case which dealt with the income tax and capital gains tax implications of the grant and exercise of share options. Prior to 2003 the exercise of a share option invariably gave rise to a capital loss equal to the amount charged to income tax. Don't ask.

In 2003 HMRC confirmed the treatment in a guidance note on the subject – but in 2009 they issued a further guidance note saying the opposite.

In the recent case of *Hely-Hutchinson v HMRC [2015] EWHC 3261*, it was explained Mr Hely-Hutchinson had been granted some options by his employer. He exercised the options and sold the shares on the same day. As a result of the decision in *Mansworth v Jelley*, and the published views of HMRC, this gave rise to a loss. However, HMRC refused relief for this loss.

Mr Hely-Hutchinson sought a Judicial Review of the HMRC decision. Whatever the strict legal analysis, Mr Hely-Hutchinson said he was entitled to the benefit of the losses on the basis of the 2003 HMRC guidance on the matter. He had a legitimate expectation that his tax affairs would be treated in accordance with this formal published guidance and the fact that HMRC changed their mind six years later should not affect the position.

HMRC said that there was an overriding public interest in them collecting the tax. (One might have said there was a rather more important public interest that public confidence in HMRC is maintained by HMRC not behaving in a manner which is conspicuously unfair.) Indeed, the Court said that although HMRC does have a public duty to collect tax, that was not a trump card which overrode everything else. They also have a co-existent public duty to treat taxpayers fairly and not to cause conspicuous unfairness by abusing their powers.

The taxpayer did have a legitimate expectation because the HMRC guidance was clear, unambiguous and without qualification which are exactly the conditions laid down by the Supreme Court in *Gaines-Cooper*.

Accordingly, HMRC were not entitled to deprive Mr Hely-Hutchinson of his loss relief calculated in accordance with their guidance in 2003.

EIS Relief

One of the (many) conditions for Enterprise Investment Scheme relief is that the relevant shares do not carry "any present or future preferential right to a company's assets on its winding up" : Section 173(2)(aa) Income Tax Act 2007.

This condition had a recent outing before the Tribunal in the case of *Flix Innovations Limited v HMRC TC 4710*. In this case the company had undertaken a bona fide commercial reorganisation of its shares which involved the creation of some valueless deferred shares which carried a right to return of their nominal value (£0.0001 each) on a winding up after the Ordinary shares had been repaid.

It was of course the Ordinary shares which were subject to the claim for EIS relief and it could hardly be denied that they had a preferential right to the company's assets in a winding up because they were entitled to have their capital returned in priority to the deferred shareholders. Accordingly, HMRC claimed that as a result of this preferential right, the EIS relief was unavailable.

Obviously the amounts involved were extremely small but the Tribunal did not consider that the preferential right could be ignored on a de minimis basis. They suggested that if Parliament had intended small or insignificant preferential rights to be ignored they would have said so. (One might have thought that given the general understanding of the de minimis principle, and indeed HMRC's explanation of the position in their Manuals, such express provision did not need to be made).

The rules for EIS are seriously complicated and the mischief of the statutory restriction was clearly not breached. However, the Tribunal did not feel that any purposive interpretation was possible to ignore any preferential right, no matter how small.

Although the HMRC Manuals explained that this issue is a matter of degree and a purely theoretical right to a residue of assets in a winding up would not be regarded as a preferential right, HMRC said that this was merely their view of the law. Quite so, in which case you would have thought this would be the basis of their argument. But no – in this case they were arguing the opposite. It is difficult to see what the taxpayer is supposed to do. HMRC will (and certainly do) criticise the taxpayers who do not pay proper regard to their Manuals but it seems that when they contain something inconvenient, HMRC claim that the Manuals should not be given any credence. Chagall would seem to have a disciple.

Reasonable Excuse

It is always interesting to see the reasoning when the Courts allow a reasonable excuse defence particularly where there is an insufficiency of funds. *Farmyard Funworld Limited v HMRC TC 4741* is just such a case.

The taxpayer was late in making some VAT payments and was charged a penalty. His defence was essentially an insufficiency of funds so you might have thought this was completely hopeless having regard to Section 71(1)(a) VAT Act which provides that:

> *"an insufficiency of funds to pay any VAT due is not a reasonable excuse."*

This is a clear statement of law and is not subject to any qualification (unlike the parallel provision for income tax purposes) relating to events outside the taxpayer's control.

However, the seriously draconian nature of this provision may be the reason why the Courts go to considerable lengths to mitigate the injustice to which it can give rise. They have done so by establishing the principle that although an insufficiency of funds cannot be a reasonable excuse, the underlying cause of the insufficiency of funds can be. This was the basis of the decision in *Customs & Excise v Steptoe [1992] STC 757*.

In the case of *Farmyard Funworld*, the company had made appropriate provision for payment of its VAT and had no reason to believe that they would be in default – until they had the money stolen which obviously made all the difference. Even so, they were only a day or so late in making the payment – but they naturally incurred a penalty.

The Tribunal referred to the Court of Appeal judgment in Steptoe and in particular where it was suggested that saying non payment was due to an insufficiency of funds would be an incomplete and misleading description of the situation. It failed to distinguish between the reason for the non payment and the excuse for non payment. There is a distinction between the trader who lacks the money to pay his tax by reason of culpable default and he who lacks the money by reason of unforeseeable and inescapable misfortune.

The Tribunal said that the taxpayer may have a reasonable excuse if the exercise of reasonable foresight and due diligence would not have avoided the problem. This was exactly the situation with *Farmyard Funworld Limited*. They could not reasonably have been expected, even exercising due diligence and reasonable foresight, to have avoided the lack of funds to pay the VAT having regard to the particular circumstances occurring so shortly before the due date.

As an interesting aside, the Tribunal considered the taxpayer's claim that the penalty would have been disproportionate having regard to the length of the default. The Tribunal took the view that although payment was only one day late, the consequence of late payment was all part of the published penalty regime which was well known to the taxpayer. It would not therefore have been disproportionate, had it applied.

P S Vaines
Squire Patton Boggs (UK) LLP
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Contact

Peter Vaines
T +44 20 7655 1780
peter.vaines@squirepb.com

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