

PRIVATE CLIENT MONTHLY TAX UPDATE WEBINARS

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INHERITANCE TAX

1. EBTs: IHT and Income Tax Issues

Context

Employment Benefit Trusts (EBTs) are discretionary trusts which seek to reward employees by making payments that favour employees or their families.

HMRC Brief 18/11 sets out HMRC's current view on IHT issues associated with EBTs. It supersedes and amplifies Revenue & Customs Brief 61/09.

It also includes material on various matters not previously addressed, including ongoing IHT liabilities of the trust and any sub-trusts it created and the taxation of income arising in offshore EBTs.

Existing cases will be taken forward by HMRC on the basis of the views set out in this Brief.

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Part 1 - Entry charges payable by a Close Company when it makes a contribution to a s86 EBT

1.1 EBT

This part of the Brief assumes that the EBT qualifies as a s86 EBT in that it is a trust where the funds are held at the trustees' discretion to be applied for the benefit of *'all or most of the persons employed or holding office with the body concerned'* (s86(3)(a)).

1.2 Charge on participators (s94)

Where a Close Company (s102(1)) makes a transfer of value (s3) to an EBT, an IHT charge arises under s94 unless, broadly, the disposition:

- is not a transfer of value under ss10, 12 or 13; or
- is eligible for relief.

1.3 Transfers of value

Where there is a transfer of value, it is apportioned between the individual participators according to their respective rights and interest in the company immediately before the contribution to the EBT is made. There is an immediate charge of 20% on the value transferred (the contribution) in excess of the participator's unused nil-rate band.

The liability for the charge to IHT that arises under s94 is the company's or, so far as the tax remains unpaid, the participator's (s202).

IHT arising under s94 is due six months after the end of the month in which the contribution is made or at the end of April in the year following a contribution made between 6 April and 30 September inclusive. Interest is charged on any unpaid tax from the due date.

1.3.1 Dispositions not intended to confer gratuitous benefit (s10)

A disposition is not a transfer of value when the terms of s10 are met. There is both a subjective test and an objective test; and both tests must be met to satisfy s10.

1.3.1.1 Subjective test - no intention to confer gratuitous intent

The test is not met if there is the slightest possibility of gratuitous intent at the date the contribution is made.

1.3.1.2 Objective test - arm's length transaction

To meet the terms of s10 the transaction either:

- must have been made at arm's length between persons not connected with each other (as defined in s270); or
- was such as might be expected to be made in a transaction at arm's length between persons not connected with each other.

An EBT is a discretionary trust and to satisfy the conditions of s86 the trustees' discretion must remain unfettered. Given that the potential beneficiaries under an EBT normally include the participators themselves; the employees or former employees; and/or the wives, husbands, civil partners, widows, widowers, surviving civil partners and children and step children under the age of 18 of such employees and former employees, it will normally be difficult to show that the conditions of s10 are met.

1.3.2 Dispositions allowable in computing profits for Corporation Tax (s12)

1.3.2.1 Overview

A disposition by a person is not a transfer of value when the terms of s12 are met: broadly, that the disposition is allowable for the purposes of calculating that person's Corporation Tax.

The relieving effect cannot be given provisionally while waiting to see whether the contribution will become allowable for Corporation Tax purposes; and is available only to the extent that a deduction is allowable to the company for the tax year in which the contribution is made.

A deduction in the Corporation Tax accounts can be permanently disallowed by the following:

- capital expenditure disallowed by CTA 2009 s53;
- expenditure not wholly and exclusively incurred under CTA 2009 s54;
- Also, the timing of a deduction can be deferred to a later period by the following:
 - generally accepted accounting practice (UITF 32) which capitalises EBT contributions by showing them as an asset on the company's balance

- sheet until and to the extent that the assets transferred to the intermediary vest unconditionally in identified beneficiaries;
- expenditure subject to s43 FA 1989 (the *Dextra* decision) - see below; and
 - post-27 November 2002 expenditure subject to CTA 2009 s1290(2)(3) - see below.

If expenditure is not allowable for any of these reasons, then s12 does not apply.

1.3.2.2 Impact of *MacDonald (HMIT) v Dextra (2005) UKHL 47*

The *Dextra* decision applies to contributions made before 27 November 2002.

In that case, the trust deed gave the trustee wide discretion to pay money and other benefits to beneficiaries and power to lend them money. The potential beneficiaries of the trust included past, present and future employees and officers of the participating companies in the *Dextra* group and their close relatives and dependants. The trustee did not make payments of emoluments out of the funds in the EBT during the periods concerned. Instead, the trustee made loans to various individuals who were beneficiaries under the terms of the EBT.

The point at issue was whether the company's contributions to the EBT were '*potential emoluments*' within the meaning of FA 1989 s43(11)(a), being amounts '*held by an intermediary with a view to their becoming relevant emoluments*'.

The House of Lords held that the contributions by the company to the EBT were potential emoluments as there was a '*realistic possibility*' that the trustee would use the trust funds to pay emoluments. This meant that the company's deductions were restricted. The company could have a deduction only for the amount of emoluments paid by the trustee within nine months of the end of the period of account for which the deduction would otherwise be due. Relief for the amount disallowed would be given in the period of accounting in which emoluments were paid.

1.3.2.3 Restriction of deductions for employee benefit contributions (FA 2003 Sch 24)

FA 2003 s143 and Sch 24 applies to contributions made after 27 November 2002 and prevents a deduction for Corporation Tax purposes until the contribution made for employee benefits is spent by a payment that has been subjected to both PAYE and National Insurance contributions. The position already established in *Dextra* is therefore effectively formalised by legislation for events on or after 27 November 2002.

1.3.3 Dispositions by Close Companies for benefit of employees (s13)

A disposition is not a transfer of value when the terms of s13 are met. However, this exclusion does not apply where (amongst other things):

- the contributions by the Close Company are made to an EBT that does not satisfy s86; or
- the participators (s102(1)) in the company and any person connected with them are not excluded from benefit under the terms of the EBT and so s13(2) applies.

1.4 Relief from IHT - business property relief or BPR (s104)

Usually, ss10, 12 or 13 will not be met and the contribution by the Close Company will be a transfer of value as a result of a reduction in the value of its estate - the aggregate of the property beneficially owned by the company.

Relief from IHT may, however, be available where the value transferred is attributable to relevant business property (s105).

The company's estate is capable of being relevant business property if it is '*property consisting of a business*' (s105(1)(a)). However, the availability of BPR is conditional on whether the transfer meets all the other requirements in Part V Chapter 1. This means, in particular that:

- the business is not an excluded one, for example a company the business of which consists wholly or mainly of making or holding investments (s105(3)); and
- the value of the relevant business property transferred is not attributable to any excepted assets (s112).

BPR will, therefore, not apply on a transfer of value made by a Close Company that is an investment company.

Part 2 - Flat rate exit charge (s72) when property leaves a s86 EBT

This part describes charges to IHT that can arise in any EBT s86, even where the original disposition into the trust was not made by a Close Company or individual.

The charge arises where a payment is made from the EBT into a sub-trust that is not itself a qualifying s86 EBT (as outlined at 1.1 above). The charge is a flat rate charge and is dependant on the length of time the property was held subject to the terms of the s86 EBT. BPR will not apply to the flat rate exit charge in these circumstances.

In addition, where there is a non-commercial loan to a participator, then an exit charge may arise under s72(2)(b).

Part 3 - Ten year and exit charges in respect of any sub-trusts

In general, sub-trusts are not s86 EBTs and are, therefore, relevant property trusts for IHT purposes (s58).

Relevant property trusts pay IHT on two key occasions:

- on the ten year anniversary of the commencement of the trust (s64) (and every subsequent ten year anniversary); and
- when property leaves the relevant property trust or when it ceases to be relevant property (s65).

For both of these occasions a calculation is required in order to establish the IHT liability, but this charge will not exceed 6% of the value of the trust assets concerned.

For the purposes of the ten year anniversary charge, the anniversary is calculated from the date on which the property became settled (s81), that is, the date the s86 EBT commenced. However, property can be treated as relevant property only when it leaves the qualifying EBT.

Where the trustees of a sub-trust decide to bring the trust to an end, an exit charge will arise under s65.

The basis of valuation for a charge arising under either s64 or s65 will be an open market value (s160) and will include the value of loans and any accrued interest.

Part 4 - Payment of ongoing IHT liabilities

Section 201(1) (settled property) outlines the persons liable for IHT on chargeable transfers arising in respect of trusts, including proportionate charges (s65) and ten year anniversary charges (s64), as well as the flat rate charge (s72) (property leaving employee trusts). Where the transfer is made during the life of the settlor and the trustees are not resident in the UK, then the settlor is liable for the ongoing trust IHT liabilities (s201(1)(d)).

The settlor of an EBT will usually be the company, whether or not it is a Close Company.

In addition, where a participator has benefited then s201(1)(c) means that they are liable for the ongoing trust IHT liabilities.

Part 5 - Income Tax assessable under the transfer of asset (ToA) legislation on income arising in offshore EBTs

5.1 Overview

It is common for the trust vehicle used as the EBT to be situated in an offshore jurisdiction and this will potentially give rise to additional liabilities where income arises within the trust.

The ToA legislation was amended by FA 2006 and the legislation applicable following this amendment can be found at ITA 2007 s714, onwards. It came into effect from 6 April 2007. The pre-FA 2006 legislation is contained in TA 1988 s739, onwards. There are two potential charges that arise under the ToA legislation - the so-called '*income charge*' (ITA 2007 s720) and the '*benefits charge*' (ITA 2007 s732). Each of these are considered in turn.

5.1.1 Income charge

The income charge provisions apply to prevent the avoidance of a liability to Income Tax by individuals who are ordinarily resident in the UK where the following conditions apply:

- there is a transfer of assets by virtue or in consequence of which, either alone or in conjunction with associated operations, income becomes payable to a person abroad; and
- the transferor has the power to enjoy the income.

For the income charge provisions to apply, the individual on whom the charge arises must be the person who transfers the assets or procures the transfer. If the offshore EBT is a normal commercial arrangement by a company to reward its employees, the transferor is the employer company; and in such circumstances the income charge is unlikely to be applicable as the transferor and beneficiaries are different people. However, it may be that the employee has transferred a right to receive a bonus into the offshore EBT and is therefore the transferor. If this is the case the ToA legislation may apply and the employee will be liable to tax on any income arising in the trust.

If the employer company is controlled by its shareholder/directors and the offshore EBT was formed solely for their benefit, the director/shareholders may have procured the transfer into the offshore EBT and could be considered transferors for the purposes of the income charge. Whether or not the ToA income charge is then applied will depend on the facts of each case.

5.1.2 Benefit charge

Where the company, not the employee, is the transferor the benefit charge may apply. The benefit charge matches any income arising within the EBT with any benefits received by the employee. The test is effectively the same as ITA 2007 s720, in that where by virtue or in consequence of a transfer income becomes payable to a person abroad, ITA 2007 s732(1)(d) applies the charge to individuals not liable to tax under the income charge. If a person receives a benefit provided out of assets available for the purpose as a consequence of the transfer, and the trustees are in receipt of income, any benefit provided to a beneficiary is potentially chargeable. The amount of the benefit charged to tax is up to the maximum of either the income or benefit. The benefit charge could, therefore, catch any income arising in the offshore EBT if it is not caught by the income charge and there are actual distributions by the trustees which are not otherwise chargeable to Income Tax.

Part 6 - Income Tax in relation to UK source income of offshore EBTs

If an offshore EBT receives UK source income, then, subject to ITA 2007 s811, the income will be chargeable to tax in the UK and the trustees should make a return of this income to HMRC. ITA 2007 s811 limits the scope of the liability to Income Tax of a non-UK resident trust provided that none of the trust's beneficiaries are resident in the UK. As EBTs are discretionary trusts, the trustees will be chargeable to tax at the trust rate under ITA 2007 s479. If the trustees make a discretionary payment out of the trust income to a beneficiary, this is treated as untaxed income of the UK resident beneficiary. It does not matter that the trustees have suffered tax on the trust income. The beneficiary returns the income received and can claim relief under Extra-Statutory Concession B18.

The trustees of the offshore EBT or sub-trusts may have advanced interest-bearing loans to beneficiaries. If the beneficiaries are resident in the UK then depending on the particular circumstances of each beneficiary, the interest will be UK source income in the hands of the trustees and should be reported as such. It is also likely that in such circumstances tax should be deducted at source by the beneficiary paying the interest under ITA 2007 s874.

Where it is contended that the interest is not UK source income, the circumstances surrounding the payment of interest will be closely examined by HMRC.

If the beneficiary does not pay the interest, but the interest is rolled up by the trustees, no immediate tax charge will arise; however, if the interest is subsequently paid or capitalised it is likely that an Income Tax charge will accrue on payment or capitalisation.

Part 7 - Payment of ongoing trust Income Tax liabilities

To the extent that income continues to arise within an offshore EBT and is caught by the transfer of assets legislation the income charge and benefits charge will continue to

apply. Likewise if the trustees continue to receive UK source income they will have an ongoing liability to Income Tax and should continue to complete Trust Returns.

Part 8 - Contact details and legal references

If you wish to notify the Trusts and Estates business within HMRC of the existence of an EBT; or, if you wish to discuss settlement of any IHT and non-resident trust liabilities that have arisen in respect of an EBT, then please contact HMRC Trusts & Estates via this link ebt@ht.settlementmailbox@hmrc.gsi.gov.uk.

Further information can be obtained by contacting the Helpline on Tel 0845 30 20 900.

(Revenue & Customs Brief 18/11 4.04.11)

Further observations

This latest offering by HMRC represents a rather more analytically argued presentation of the technical issues involved in EBT's than did the 2009 Brief - though very much from HMRC's point of view and (as suggested below) counter-arguments may be raised. Indeed, many commentators took issue with the content of Revenue and Customs Brief 61/09 where, somewhat out of the blue, HMRC fired their first salvo on the IHT aspects of EBT's. This I rather felt was intended to put the frighteners on professionals who might be tempted to indulge in such things and also hinted at the possible emergence of a test case, though no-one to whom I have spoken seems to have any information here.

The central focus of the 2009 statement, picked up by the commentators, was whether any IHT implications could be avoided by successfully arguing for the application of IHTA 1984 s10, that is no gratuitous benefit (helped by the 2007 Special Commissioner's decision for the taxpayers in *Postlethwaite's Executors v HMRC* [2007] SSCD 83 (SpC 571), on the grounds of a commercial justification for payment by the deceased taxpayer's service company of a lump sum of £700,000 into his pension fund. This issue also touches on the *bona fide* commercial aspects of the transfers of assets abroad regime (see below).

The point is made (at 1.2 on page 1 above) that the s94 charge on participators is avoided if any of sections 10, 12 or 13 applies – or indeed if the chargeable transfer is covered by 100% business property relief. The problem is that HMRC seem to add their own gloss on the statutory provisions. For example, to say at 1.3.1.1 that the subjective s10 test is not met *'if there is the slightest possibility of gratuitous intent at the date the contribution is made'* is clearly overstating the position. Similarly, at 1.3.1.2 HMRC state, that to satisfy the s86 Employee Benefit Trust conditions, *'The trustees' discretion must remain unfettered'*: no such limitation appears in the statute.

On the section 12 let-out (dispositions allowable in computing profits for Corporation Tax), HMRC say, mistakenly, that the relieving effect *'is available only to the extent that a deduction is allowable to the company for the tax year in which the contribution is made'*. But that is not what the legislation says, clearly envisaging that a deduction can be made in a subsequent year. [As a practical matter, it is not clear what would happen then: the chargeable transfer would have arisen under IHTA 1984 s94 and presumably the IHT would have been paid. Subject to limitation periods, would it be possible to apply for overpayment relief once the deduction had been obtained through the

application of s12? Otherwise there seems to be no mechanism in the Act for achieving what must be the proper result.]

As to section 13 (dispositions by close companies for the benefit of employees), HMRC say correctly that this requires exclusion from benefit of all participators and persons connected with them. This certainly seems to be the easiest way to avoid an s94 charge – though at the cost of severely restricting the class of beneficiaries under the s86 trust. As always under a trust, it is possible that some benefit may go to an individual who is expressly excluded from benefit, which would constitute a breach of trust. In such circumstances HMRC in the present context have said in the past that the s13 let-out would not apply.

As concerns BPR (1.4), this was not mentioned in the 2009 statement and picks up an intriguing suggestion made by Ian Maston in an article in *Taxation*, following the High Court decision in *Nelson Dance* in favour of the taxpayer. On that basis there must be an argument that even a transfer of cash which diminishes the 'estate' of the company can attract BPR, insofar as it is attributable to '*relevant business property*', namely the shares in the company.

On Income Tax (part 5), HMRC fail fairly to reflect the motive test (substantially revised in 2005): provided that the taxpayer can show no tax avoidance purpose and that it was a *bona fide* commercial arrangement, the regime will not apply – and in many cases there must be a strong case for this.

2. BPR and Group Structures: Exchange of Correspondence Between HMRC and CIOT

1. Introduction

1.1 HMRC have agreed that correspondence with the CIOT's Succession Taxes Subcommittee may be published. Sections 2 and 3 below set out the query made on 15 December 2010 and HMRC's response of 10 January 2011 is at Section 4.

2. The issue

2.1 *We have received a number of queries about the availability of business property relief (BPR) for shareholdings in the holding company of a group of companies.*

2.2 *While we think that the answer to the question should clearly be that relief is available, we thought it sensible to ask for HMRC's views so that the matter can be put beyond doubt.*

2.3 *The exact facts of each case obviously differ, but a typical scenario would involve a holding company whose main activity is ostensibly holding shares in trading subsidiaries(1). The holding company's business may also involve various other non-trading(2) activities but where – subject to the following – the holding of shares in trading subsidiaries clearly predominates.*

(1) We use 'trading' as a shorthand for the test in s105(3), namely that the company in question's business does NOT consist wholly or mainly of dealing in securities, stocks or

shares, land or buildings or making or holding investments. We appreciate that, in practice, there may be some distinctions between the two.

(2) In the same sense as the previous footnote.

2.4 However, in addition to its shareholding in the trading subsidiaries, the holding company may also have made intra-group loans to the trading subsidiaries.

2.5 If this loan is – under IHTA 1984 s105(4) - treated as part of the holding company's 'business of being a holding company of [s105(3) qualifying] companies' then the trading side of the business will still predominate. However, if the loan is treated as being on the 'wrong side of the line', then it may tip the balance so that non-trading activities predominate, thus denying BPR entirely to the shareholdings in the holding company.

3. Legislative background

3.1 BPR is available where whole or part of the value transferred by a transfer of value is attributable to the value of the relevant business property. The relief operates by treating the whole or part of the value transferred as reduced by 100% (IHTA 1984 s104).

3.2 IHTA 1984 s105(3) sets out a test whereby BPR is not available, and this test is framed in the negative. All shareholdings potentially qualify for BPR unless the business of the company consists wholly or mainly of certain excluded activities.

3.3 IHTA 1984 s105(3) would preclude most group structures. However, there is an exception at s105(4) for holding companies.

3.4 This exception does not focus on the group as a whole, but on the business of each separate company in that group. The nature of each company's business is looked at, starting with the business carried on by the holding company.

Is there a business in this case?

3.5 In order to qualify for BPR it is necessary to establish that there is indeed a 'business' at all. In this example, it is assumed that HoldCo is carrying on a business.

3.6 It is also assumed in this case that there is a single business and that the business is carried on for gain IHTA 1984 s103(3).

What is the business of HoldCo?

3.7 The crucial test as to whether BPR applies is whether the business of HoldCo consists predominantly of being a holding company of one or more companies (IHTA 1984 s105(4)).

3.8 There is then a definition of 'holding company' which cross-refers to Companies Act 2006 s1159 and Schedule 6. That definition refers simply to a company being a subsidiary of another company (its 'holding company'), if the holding company:

- (a) holds a majority of votes in the subsidiary; or
- (b) is a member of the subsidiary and has the right to appoint and remove the majority of its board of directors; or
- (c) is a member of it and controls.....a majority of the voting rights in it.

3.9 Schedule 6 contains some further amplification of the above tests, but does not alter the substance of s1159.

3.10 What is unclear is whether - when this definition is transposed into IHTA 1984 s105(4) - it provides an exhaustive definition of 'a business consisting...of being a holding company'. Or, putting it another way, does the incorporation of s1159 define 'holding company' or 'the business of being a holding company'? And, if the former, of what does the business of being a holding company consist?

3.11 The distinction is important, because if the incorporation of s1159 provides an exhaustive definition of the business of being a holding company, then other activities (such as loans to subsidiaries) presumably do not form part of that business and therefore fall the wrong side of the s105(4) line. Conversely, if the business of being a holding company is a wider concept then providing loan-finance to subsidiaries would, we suggest, be treated as an ordinary activity which many holding companies would undertake.

3.12 We think that it is generally accepted that the latter view is the right one, but we think that HMRC's confirmation of this would be sensible.

3.13 We would accept that the wider definition still lacks clarity as to what the business of being a holding company consists of. This is presumably a question of fact to be answered in each case. We would suggest that a tentative description of the business of a holding company could include one or more of the following activities:

- (a) holding the shares in subsidiaries;
- (b) co-ordinating the activities of those subsidiaries by means of voting control and the ability to control the subsidiary boards;
- (c) provision of loan and other finance to those subsidiaries;
- (d) providing strategic direction and oversight of the activities of subsidiaries and ensuring that the subsidiaries work together to achieve a common aim;
- (e) monitoring the financial performance of subsidiaries; providing a 'treasury' function and co-ordinating guarantees and cross-group collateral;
- (f) providing a structure to allow ring-fencing of the activities of subsidiaries; nurturing new higher-risk activities within the limited liability offered by subsidiaries; re-organising the businesses of subsidiaries as they change and grow; and
- (g) managing relations with shareholders on behalf of all subsidiaries.

3.14 We would, however, welcome HMRC's views on this question to put the matter beyond doubt.

4. HMRC's reply of 10 January 2011

4.1 Companies Act 2006 s1159 defines the structural relationship between a holding company and a subsidiary in terms of control and voting rights. Reading this into IHTA 1984 tells us whether or not a company is (structurally) a holding company, but does not provide any definition of what the business of that holding company may be. HMRC look at the activities undertaken by any particular company from first principles to determine what the main business of that company is and whether it falls within the provisions of IHTA 1984 s105(4)(b). We apply the factors as set out in the Farmer case and look at the business 'in the round'.

4.2 All cases depend on their own facts, but we agree that the following activities are indicative of the business of a holding company:

- (a) holding the shares in subsidiaries;
- (b) co-ordinating the activities of those subsidiaries by means of voting control and the ability to control the subsidiary boards;
- (c) provision of loan and other finance to those subsidiaries;
- (d) providing strategic direction and oversight of the activities of subsidiaries and ensuring that the subsidiaries work together to achieve a common aim;
- (e) monitoring the financial performance of subsidiaries; providing a 'treasury' function and co-ordinating guarantees and cross-group collateral;
- (f) providing a structure to allow ring-fencing of the activities of subsidiaries; nurturing new higher-risk activities within the limited liability offered by subsidiaries; re-organising the businesses of subsidiaries as they change and grow; and
- (g) managing relations with shareholders on behalf of all subsidiaries.

4.3 If these or similar activities predominate and the group subsidiaries are themselves non-investment companies, then BPR would normally be available for the shares in the holding company.

4.4 In relation to intra-group loans, these are regarded as non-investment where the loans are used by the subsidiaries for the purposes of their non-investment businesses and the amounts are reasonable in the context of the group business as a whole.

4.5 We will take account of your query and this response when we next come to update our published guidance on BPR. In the meantime, I hope your members find this message helpful.

(CIOT release posted in the STEP UK News Digest 4.04.11)

Further observations

This generally is helpful as confirming HMRC's agreement with the CIOT view that the Companies Act 2006 definition of a holding company is non-exhaustive. Indeed, HMRC hint at 4.2 that they would even expect a holding company to be doing rather more than merely holding shares in subsidiaries.

(a) An omission – occupation of land by subsidiaries

One rather surprising omission from the CIOT list of activities, it seems to me, is the ownership and making available of land and buildings to subsidiary companies for purposes of their business (whether trade or investment). (I have in mind to put this to the CIOT and see whether the issue has been raised with HRMC). It was suggested at MTR London that the point has been considered in a Readers' Forum exchange in *Taxation* in the recent past. Might the analysis depend on whether or not the subsidiaries paid rent for their occupation, which they might do in order to put the parent company in funds to pay interest on the borrowings taken out to acquire the land? On the other hand, given that the payment of rent is generally structurally bad news only for Capital Gains Tax, in the context of entrepreneurs' relief and associated disposals (and indeed retirement relief which preceded it), and as is well-known does not inhibit the availability of BPR, there could be an argument that the payment of rent does not matter.

Ian Maston of Gabell LLP has sent me the following, written by him in *Tolley's Tax Planning for Owner Managed Businesses*:

Where, within a group, there is a subsidiary company which is itself wholly or mainly carrying on an investment business, the value of that subsidiary is denied BPR (IHTA 1984 s 111). Thus, in Example 1 above, the value of Company (C) would not attract relief.

This rule is, however, subject to the caveat that if that investment subsidiary's main business is 'wholly or mainly' the holding of land for other group trading companies, its value will not be denied relief (IHTA 1984, s 111(b)).

Interestingly, this caveat appears - on a strict reading of the legislation - to apply only to subsidiary companies within a group and not to the holding company of a group. Thus, where a holding company owns a property which is let to one of its trading subsidiaries, that property could be considered as an investment of the holding company when identifying the holding company's main business. The counter argument would be that in these circumstances it would be wrong to think about the property as an 'investment' of the holding group - rather it is a property held to facilitate the trade in other parts of the group - and it is to be hoped, in any event, that HMRC would never seek to use such an anomaly to deny BPR to a bona fide trading group.

Ian has written to me that he based the final point from the following statement taken from the Shares Valuation Manual that they would look at a group structure 'as a whole' ie rather than by a forensic examination of just the holding company's activities...

*'(SVM111190) Subject to the paragraphs below relating to s111 the only grounds on which relief may be denied under s105(3) are if the business of the holding and subsidiary companies viewed **as a whole** does not fall within s105(4)(b). The test is a factual one. Accordingly, the activities, income sources and asset values of the parent and each of its subsidiaries must be examined to form a picture of the group business.'*

Generally, it must be preferable for the group to hold the land within a subsidiary, which clearly would not prejudice relief. By contrast, if held in the top company, there must be a danger of either HMRC taking the technical point in future or indeed of the adverse effect of shifting values if any investment characteristics of the land were to outweigh the value of the trading aspects of the holding company's business.

It should be emphasised also that the holding company must indeed carry on a business (see 3.5 of the CIOT letter).

Certainly the exchange of correspondence is a salutary reminder that, in any case where the relationship of holding company/subsidiary company does not apply within the Companies Act test (eg only a 40% shareholding is owned with no power to hire and fire directors etc), the company in which the minority holding is owned will constitute an investment so far as the holding company is concerned - even if that subsidiary carries on a trade. There is the related point that a trading partnership which wholly owns shares in a trading company may find BPR restricted in that the subsidiary will be an investment.

(b) Nature of borrowing companies

I do take issue with HMRC's statement at 4.4, in the light of the Special Commissioner's decision in *Philips and Others (Philips Executors) v RCC* [2006] SSCD 639 SpC 555. There a majority holding in a company which had sold its land portfolio and used its resulting cash pot to make loans to related family companies on various terms was not an investment activity. As I recall it, the fact that many of the borrowing companies were investment not trading companies did not affect the analysis.

CAPITAL GAINS TAX

3. Intangible Fixed Assets (*Greenbank*)

Greenbank Holidays Ltd (Greenbank) purchased the goodwill of another company (K) in the same group in 2003. In its Corporation Tax return Greenbank claimed a substantial deduction for the cost of the goodwill. HMRC rejected the claim on the grounds that it had been created by K before 1 April 2002, and thus failed to meet the requirements of FA 2002 Sch 29 para 118.

The First-tier Tribunal dismissed Greenbank's appeal and the Upper Tribunal upheld this decision. Arnold J observed that *'it is manifest that what happened on 30 September 2003 was that [K] sold and [Greenbank] purchased that goodwill'*. The accounting treatment which Greenbank had adopted did not mean that the goodwill either came into existence for the first time or that it was a different asset from the goodwill owned by K.

Why it matters

The Upper Tribunal upheld the First-tier Tribunal decision that *'goodwill'* includes internally generated goodwill as well as purchased goodwill. See now CTA 2009 s715(3).

(Greenbank Holidays Ltd v RCC, Upper Tribunal – 13.04.11, reported in the Tax Journal 22.04.11 p4)

INCOME TAX

4. **Anti-avoidance: Second-Hand Insurance Policies: Deficiency Relief *Mayes***

Context

The issue was whether, as a matter of law, and as was held by the Special Commissioner, the pre-ordained, composite, artificial and tax-motivated events in SHIPS 2 were to be disregarded for fiscal purposes; and whether, for CGT purposes, the taxpayer had suffered an allowable loss of £131,326 on the disposal of the bonds when he surrendered them for £1,780.94.

Mayes v RCC: the facts

This appeal concerned a tax avoidance scheme, marketed as 'SHIPS 2', using payments of premiums to and subsequent surrenders in part and then fully of existing non-qualifying life assurance policies (or second-hand insurance policies) (the bonds) with the objective of providing relief against higher rate Income Tax for UK resident individuals in 2003/04.

The scheme involved seven steps: (1) A Jersey resident individual purchased from AIG Life, by means of single premiums of £5,000, two bonds comprising several policies on his life. (2) He assigned the bonds to a Luxembourg company (JSI) for value. (3) JSI paid £375,000 to AIG Life in respect of each policy in the first bond and £50,000 in respect of each policy in the second bond. (4) JSI withdrew from the bonds all the sums paid at step (3). (5) JSI assigned the bonds to a limited liability partnership (LLP) for value. (6) The LLP assigned the bonds to Mr Mayes. (7) Mr Mayes surrendered both bonds to AIG Life, receiving in return the remaining proceeds in the bonds.

Mr Mayes claimed that by use of this scheme he became entitled to a deduction of £1,876,134 against other income for higher rate Income Tax purposes for purposes of the tax relief given by TA 1988 Pt XIII Ch II (as a result of corresponding deficiency relief). He also claimed relief of £131,323 against gains liable to Capital Gains Tax for losses on the disposal of policies during that year. HMRC concluded that there was no capital loss arising from the disposal of the policies and also that there was no corresponding deficiency on which to claim relief from higher rate Income Tax.

On Mr Mayes' appeal, the Special Commissioner found that payments into and out of SHIPs did not give rise to corresponding deficiency relief from Income Tax ((2008) SpC 729). He accepted HMRC's contention that steps 3 and 4, the part of the scheme whereby additional premiums were added and the amounts of those premiums withdrawn within the same month, were self-cancelling transactions devoid of commercial content which could be disregarded. However, since there was no corresponding deficiency relief for Income Tax purposes, Mr Mayes did have a capital loss in buying the bonds.

The High Court allowed Mr Mayes' appeal against that decision on the corresponding deficiency relief issue. However the judge found that the case had to be remitted to the First-tier Tribunal (Tax Chamber) to make findings of fact as to whether sums paid for such policies purchased to claim Income Tax relief produced an allowable loss for CGT purposes. HMRC appealed and Mr Mayes cross-appealed.

The decision: CA (Mummery, Thomas and Toulson LJJ)

The Court of Appeal upheld a decision of the High Court that payments into and out of second-hand insurance policies (SHIPs) gave rise to corresponding deficiency relief from Income Tax since the insertion of self-cancelling steps into the so-called 'SHIPS 2' tax avoidance scheme for tax advantage purposes could not deprive those steps of their fiscal effects.

Corresponding deficiency relief

The decision in *WT Ramsay Ltd v IRC* [1982] AC 300 did not lay down a special doctrine of revenue law striking down tax avoidance schemes on the ground that they were artificial composite transactions and that parts of them could be disregarded for fiscal purposes because they were self-cancelling and were inserted solely for tax avoidance purposes and for no commercial purpose. The *Ramsay* principle was the general principle of purposive and contextual construction of all legislation. The TA 1988 was no exception and was not immune from it. That principle had displaced the more literal, blinkered and formalistic approach to revenue statutes often applied before *Ramsay*.

The essence of the principle applicable to this case was that the TA 1988 provisions on the taxation of life insurance policies were to be given a purposive construction in order to determine the nature of the transaction to which they were intended to apply. The court then had to decide whether the actual transactions (in this case steps 3 and 4) answered to the statutory description, having taken account of their overall effect as elements of SHIPS 2 that were intended to operate together.

The decision in *Barclays Mercantile Business Finance Ltd v Mawson (HMIT)* [2004] BTC 414 made it clear that under the *Ramsay* principle there were two stages in the application of the statutory provisions: a purposive construction of the statute to see, on a close analysis, what transaction would answer to the statutory provision and a realistic analysis of the transaction to see whether it answered to that description. It was wrong to elide the two stages by sweeping generalisations about disregarding for fiscal purposes elements that were inserted only for fiscal avoidance reasons and had no commercial purpose.

On the proper construction of the TA 1988 provisions for the taxation of life policies, the statutory requirements as to the transactions to which the provisions were intended to apply were far removed from the kind of case in which the focus was simply on an end result, such as a loss. **In this case the all-important corresponding deficiency relief available under TA 1988 s549 was the product of real premiums paid at an earlier stage for real life policies and real surrenders made at an earlier stage. Although the corresponding deficiency was created solely to save tax, that alone did not entitle the court to disregard the fiscal consequences of payment of premium and the partial surrender which led to its creation.**

It would be an error, into which the judge had not fallen, to disregard the payment of a premium at step 3 and the partial surrender at step 4 simply because they were self-cancelling steps inserted for tax advantage purposes.

It was right to look at the overall effect of the composite step 3 and step 4 in the seven-step transaction in the terms of TA 1988, to determine whether it answered to the

legislative description of the transaction or fitted the requirements of the legislation for corresponding deficiency relief. So viewed, steps 3 and 4 answered the description of premium and partial surrender. On the true construction of the TA 1988 provisions, which did not readily lend themselves to a purposive commercial construction, step 3 was in its legal nature a premium paid to secure benefits under the bonds and step 4 was in its nature a withdrawal of funds in the form of a partial surrender within the meaning of those provisions. They were genuine legal events with real legal effects.

The court could not, as a matter of construction, deprive those events of their fiscal effects under TA 1988 because they were self-cancelling events that were commercially unreal and were inserted for a tax avoidance purpose in the pre-ordained programme that constituted SHIPS 2. It followed that a corresponding deficiency relief was available to Mr Mayes.

Capital Gains Tax

Remission of the CGT issue was necessary to resolve an issue that ought to have been resolved by the Special Commissioner either as, or as raising, a question of fact. The Special Commissioner had erred in law in not resolving the amount of the consideration wholly and exclusively paid by the taxpayer for the acquisition of the bonds. According to the decision of the Court of Appeal in *Drummond v RCC* [2009] BTC 312, the ascertainment of the consideration on the application of the 'wholly and exclusively' tests in TCGA 1992 s38(1)(a) was an issue of fact for the First-tier Tribunal and not a question of law. It could not be said that a remission was unnecessary on the ground that there was only one possible factual finding that the Special Commissioner could have made on the CGT issue (*Spectros International plc v Madden (HMIT)* [1997] BTC 74 considered).

The judge had correctly found that the Special Commissioner's decision on that point had erred in law and that remission to the First-tier Tribunal was the appropriate response in order to decide what he had not decided. At the remitted hearing there could be full argument on both the applicable law and as to what, as a matter of fact, constituted the relevant amount of the consideration paid by the taxpayer for the acquisition of the bonds.

(Mayes v RCC [2011] EWCA Civ 407, 12 April 2011, reported at CCH Taxes Weekly Tax News Issue 15 21.04.11)

Further observations

This resounding endorsement by the Court of Appeal of Proudman J's decision to the High Court stands out as something of a beacon in the recent run of avoidance decision in favour of HMRC in the Courts. HMRC may be expected to try to take this case to the Supreme Court.

One particular point of interest is the CA's clear statement that the *Ramsay* principle is not 'a special doctrine of revenue law striking down tax avoidance schemes on the ground that they were artificial composite transactions and that parts of them could be disregarded for fiscal purposes because they were self cancelling and were inserted solely for tax avoidance purposes and for no commercial purpose'. That is, the *Ramsay* principle is a 'general principle of purposive and contextual construction of all legislation',

as fleshed out in the 2004 decision of the House of Lords in *Barclays Mercantile*, also applied by the CA to the facts of this case.

The CA were bound to apply the legislation to the facts of the case, noting that if the taxpayer is ultimately successful and the result is not to the liking of HMRC and Parliament, then the legislation can always be changed by due democratic process. Meanwhile, it is not clear that the legislation has indeed yet been changed.

It might now be interesting to speculate on what other, similarly mechanistic, regimes in the tax legislation might be similarly capable of exploitation by the well advised taxpayer.

5. Jointly-Held Property: Whether Appellant a Settlor (*Lather*)

A married couple held joint bank accounts, on which interest arose. Mr Lather failed to declare any of this interest on his tax returns. HMRC issued amendments to his self-assessments, and discovery assessments for previous years, on the basis that Mr Lather was taxable on 50% of this income. **Mr Lather appealed, contending that the interest should be treated as belonging solely to his wife. The First-tier Tribunal rejected this contention and dismissed his appeal, observing that Mr and Mrs Lather could have made a declaration of unequal beneficial interests under what is now ITA 2007 s 837, but had failed to do so.**

In the same case, L's two young children received income from several building societies. HMRC issued assessments on Mr Lather on the basis that he had settled the relevant capital on his children. **Mr Lather appealed, contending that the funds derived from the children's grandfather, for whom he held a power of attorney (and who had died before the hearing of the appeal). The First-tier Tribunal accepted this contention and allowed the appeals on this point, finding that the grandfather had been the settler.**

Why it matters

This case has already gained some publicity because the appellant is a well-known London councillor. From a tax perspective, the significance of the case lies in the application of ITA 2007 s837, which provides that a couple may make a '*declaration of unequal beneficial interests*' where it is appropriate to do so.

(PA Lather v HMRC (No 1) (TC977 – 1.03.11) reported at The Tax Journal 25.03.11 p4)

Further observations

The declaration of unequal beneficial interests under ITA 2007 s837 applies only to spouses or civil partners. The proportions declared (of other than 50/50) must follow the actual beneficial interests, no doubt evidenced by a declaration of trust. Any gift between the parties will typically be spouse exempt (subject to the limitation for non-UK domiciled transferees in IHTA 1984 s18(2)).

6. Trust Management Expenses - Revised Guidance

HMRC Trusts & Estates have recently published revised guidance on trust management expenses at TSEM8000 to TSEM8790. This section of guidance has been substantially rewritten to reflect the outcome of the Clay case - *HMRC v Trustees of the Peter Clay Discretionary Trust* [2009] STC 469.

The new sections embrace the following

- TSEM8000 - Trust management expenses: Table of contents.
- TSEM8005 - Trust management expenses: introduction: what are TMEs?
- TSEM8100 - 'Properly chargeable to income' in general trust law: contents.
- TSEM8200 - Trust management expenses: accumulation/discretionary trusts: contents.
- TSEM8300 - Trust management expenses: IIP trusts: contents.
- TSEM8400 - Trust management expenses: bare trusts: contents.
- TSEM8500 - Trust management expenses: settlor-interested trusts: contents.
- TSEM8600 - Trust management expenses: mixed trusts: contents.
- TSEM8700 - Trust management expenses: allowable expenses: specific items: contents.

(HMRC website *What's New?* 8.04.11)

Further observations

It is indeed the case that the CA decision in *Peter Clay* allows apportionment of particular expenses, typically trust management fees, as between capital and revenue. However, HMRC will require good supporting records (ideally, contemporaneous with the work done) to support the claimed apportionment.

7. Residence: The Full-time Working Abroad Test & HMRC's *de minimis*

My summary

In early April HMRC published further guidance on full-time work abroad. HMRC say that this will normally be a minimum of 35 hours per week. They have also stated that they will generally accept that working in the UK for fewer than 10 days a year will not of itself prevent an individual claiming that they made a break with the UK because they are working full-time abroad (apparently, as something of a *de minimis* rule). The guidance goes on to suggest the content of the necessary evidence and demonstration to back up a claim. Note that, although the guidance refers to 10 work days, work days which are merely incidental to UK duties are considered as performed abroad and do not count towards the 10-day test. So at this stage it looks as though less than 10 days can be spent in the UK on non-incidental duties without breaching the full-time employment abroad status, which is interesting and generous – but should perhaps be treated with caution, at least pending further clarification.

Professional comment

Under case law, individuals who leave the UK for full-time work abroad can become non-UK resident despite retaining links with the UK such as keeping a home here. But the exact meaning of '*full-time work abroad*' has been uncertain. In particular, how much work can be done in the UK? HMRC have now issued new guidance confirming that

working in the UK for fewer than 10 days in a year will generally be accepted as not by itself preventing an individual from claiming that they have made a break with the UK because they are working full-time abroad. If 10 or more days are worked in the UK, then whether the individual is working '*full-time abroad*' will depend upon their particular circumstances. The timing of the announcement so late in a tax year to which HMRC suggests the new guidance applies may cause difficulties...

HMRC's announcement indicates that their 10 days *de minimis* day limit may be regarded as continuing into the 2011/12 tax year. The implication is clearly that this has applied throughout the 2010/11 tax year also, if not in earlier years. For an announcement made with only five days of the 2010/11 tax year remaining, this would appear to indicate that this has been previously stated practice, whereas in reality there has been no formal guidance in this area. It remains to be seen how aggressively HMRC will attempt to apply this treatment to tax returns filed for 2010/11 and earlier tax years. We welcome the certainty which the new statement offers, but it would have been more realistic, given the timing of the announcement, had HMRC indicated that they were intending to apply it for the 2011/12 rather than the 2010/11 tax year. Taxpayers and their employers, who may worry about the PAYE implications, are likely to be very disappointed, and should consider what actions they can take to manage their position in relation to this announcement.

(The Tax Journal, 15.04.11 p6 contribution by Carol Stubbings of PwC)

Further observations

It seems that HMRC have introduced the *de minimis* test of fewer than 10 days work in the UK in the tax year to provide conformity with the National Insurance position. HMRC 6 is in the course of being revised.

Note too that earnings properly attributable to the fewer than 10 days working in the UK will be ordinarily chargeable to UK tax.

The '90 day' test is 'not what it was' and is applied principally by HMRC 6 in the case of individuals coming to rather than leaving the UK. On the other hand, it is specifically applied by HMRC at para 8.5 of HMRC 6 in terms of testing whether the full-time employment abroad test is satisfied: one of the conditions is that visits to the UK after leaving to begin the employment averaged less than 91 days a tax year, over the period of absence, up to a maximum of four years.

The big advantage of the full-time employment abroad let-out, as against the more general category of becoming non-UK resident, is that for purposes of the latter it is now well-established that a 'complete break' is required, including sale (or at least long term letting) of the family home, severance of social and business ties etc. However, provided that the taxpayer has left the UK for full-time employment abroad over at least a complete tax year, then other ties with the UK can be retained, including property and social/business connections etc. In this context, satisfaction of the 91 day test is unlikely to prove a problem.

8. Political Unrest in Bahrain and the UK Residence Rules

HMRC made an announcement in February 2011 about the '*exceptional circumstances*' arising from the political unrest in Egypt, Tunisia and Libya and the UK residence rules. Extra days spent in the UK purely as a result of evacuations from these countries will constitute '*exceptional circumstances*' and so be disregarded in considering whether an individual is resident in the UK.

HMRC have confirmed that the Foreign and Commonwealth Office (FCO) has advised individuals in Bahrain to leave as soon as it is safe to do so. This advisory came into effect from 16 March 2011.

'Exceptional circumstances' will only apply for the period individuals were advised by the FCO to leave Bahrain and the week thereafter.

(TAXline April 2011 p7 article by Paula Clemett)

MISCELLANEOUS

9. SDLT When the 5% Rate Applies – An Overview

Context

- Finance Act 2010 introduced a new 5% rate of SDLT for residential property transactions where the chargeable consideration exceeds £1 million.
- The new rate applies to transactions where the effective date is on or after 6 April 2011.
- The existing 4% rate will still apply to residential property transactions where the consideration is more than £500,000 and does not exceed £1 million.
- Transitional arrangements apply to transactions where a contract was entered into before 25 March 2010 (Budget Day) but is not completed before 6 April 2011. In most such cases the new rate will not apply.
- Non-residential and mixed use transactions are not affected.
- HMRC online calculators have been amended to reflect the new rate.

What is treated as residential property

Residential property is property which is used, suitable for use or being adapted for use as a dwelling, together with certain land and buildings associated with the dwelling. There are detailed rules determining whether certain types of institutional accommodation count as a dwelling.

SDLT transactions when the 5% rate applies

The 5% rate applies to the following transactions:

- transactions which consist wholly of residential property and where the chargeable consideration exceeds £1 million; and
- linked transactions which consist wholly of residential property where the aggregate chargeable consideration exceeds £1 million.

SDLT transactions when the 5% rate does not apply

The following transactions are treated as non-residential for SDLT purposes so the 5% rate does not apply:

- transactions which consist partly of residential and partly of non-residential property and where the chargeable consideration exceeds £1 million;
- linked transactions which consist partly of residential and partly of non-residential property where the aggregate chargeable consideration exceeds £1 million; and
- single transactions comprising of six or more separate dwellings.

Contracts before 25 March 2010

Where a contract was entered into before 25 March 2010, the new rate will not apply if the contract is substantially performed before 6 April 2011, or it is completed after that date and, on or after 25 March 2010:

- the contract was not varied or the rights under it assigned;
- there was no exercise of any option, right of pre-emption or similar right; and
- there was no assignment, sub-sale or other transaction involving all or part of the subject-matter of the contract.

(HMRC website What's New? 30.3.11)

10. Overseas Holiday Homes Purchased Through a Limited Company: National Insurance Rationalisation

Context

FA 2008 introduced new provisions to ITEPA 2003 ss100A and 100B. These provisions effectively provide an exemption from the living accommodation tax charge where living accommodation outside the UK is provided by a company for a director or other officer of the company (D) or a member of D's family or household where all of the following apply:

- the company is wholly owned by D or D and other individuals (and no interest in the company is partnership property);
- the company's main or only asset is a relevant interest in the property; and
- its only activities are ones that are incidental to its ownership of that interest.

The new legislation was treated as having always had effect. In other words, the new legislation meant that since the coming into force of these provisions in the Finance Act 2008 a charge to Income Tax on the benefit provided through a qualifying overseas holiday home has never existed. As a consequence any liability to Class 1A National Insurance contributions, which was due on an amount equivalent to the general earnings charge in ITEPA, was also removed from 21 July 2008. At that time HMRC advised that refunds of tax could be claimed on the basis that the living accommodation tax charge was never intended to apply in these circumstances and the new legislation is treated as always having had effect.

However the same was not the case for Class 1A National Insurance contributions (employer only). In the case of overseas holiday homes, it remained the case that for the years prior to the enactment of Finance Act 2008, Class 1A NIC remained due on the benefit in kind chargeable to Income Tax. HMRC published Regulations on 17 March 2011 that align the National Insurance contributions position with that for Income Tax - The Social Security (Contributions) (Amendment No. 3) Regulations 2011 (SI 2011/797). **This means that it is now possible to claim a refund of Class 1A NIC in the same way as it was possible for Income Tax.** A refund of Class 1A NIC can be claimed where contributions have been paid and an officer of HMRC is satisfied that the contribution was paid on the same amount treated as earnings that are now exempt under the relevant legislation in ITEPA 2003.

Refunds

Any individual who can show that they have paid Class 1A NICs for any year before 2008/09 on the benefit of living accommodation which qualifies for exemption in accordance with of ITEPA 2003 ss100A and 100B should write giving the information listed by HMRC to:

HMRC
Customer Operations PAYE Employer Office
BP4009, Chillingham House
Benton Park View
Longbenton
Newcastle upon Tyne
NE98 1ZZ

Time limit for making a refund claim

Any application for a refund in these cases must be made in writing on or before 6 April 2015.

HMRC will take action to identify those taxpayers who have previously claimed refunds of tax and Class 1A NIC and arrange to refund the Class 1A NIC already paid. However, if you wish to submit details of your original claim again please quote any reference number that you were given previously and send it to the above address.

(HMRC website What's New? 14.04.11)

11. New Gift Aid Forms

New forms replace the current forms on the 2009 Gift Aid Toolkit CD and the internet, including the repayment form R68. You can download the new forms from HRMC's website and complete them on your computer.

HMRC also publish 12 helpsheets regarding Gift Aid, including highlighted tips which can be used to make tasks easier during the claims process.

(HMRC website What's New? 30.03.11)

Further observations

I have heard that the taxpayers in *Harris* (see MTR 10/10 Item 4.2) have withdrawn their appeal to the Upper Tribunal. This is a pity, as it leaves what is widely thought to be the mistaken 1997 Special Commissioner's decision in *St Dunstan's v Major* as the guiding authority.

12. SA: New Penalties for Late Filing and Late Payment

Context

HMRC are changing the way they deal with people who fail to meet their SA deadlines. The new rules start from April 2011 and apply to notices and returns for 2010/11 and later tax years.

Penalties if you miss the tax return deadline

If you miss the deadline, the longer you delay, the more you will have to pay. So it is important to send your tax return to HMRC as soon as you can.

If, for example, you send your tax return back six months late, you will be asked to pay the first three penalties shown in the table below.

All of the penalties shown in the table below will be charged even if you have no tax to pay or have paid the tax you owe.

Penalties for sending your tax return late

Length of delay	Penalty you will be asked to pay
One day	Initial £100
Three months	£10 each day - up to maximum of £900.
Six months	£300 or 5% of the tax due, whichever is the higher.
Twelve months	£300 or 5% of the tax due, whichever is the higher. In serious cases you may be asked to pay up to 100% of the tax due instead.

The deadlines and penalties above also apply to each partner in a partnership.

Having a reasonable excuse for missing the deadline

You will not have to pay a penalty if you have a reasonable excuse for missing the deadline. For example, there may have been an exceptional or unexpected event, beyond your control, that prevented you from sending your return on time. In this case, you must send your return as soon as possible once the problem ends.

There are no hard and fast rules, but some examples of what HMRC may consider a reasonable excuse are:

- documents lost through theft, fire or flood that cannot be replaced in time;
- life-threatening illness, for example a heart attack that prevents you dealing with your tax affairs;
- death of a partner shortly before the deadline;
- industrial action by Royal Mail over a lengthy period of time; and
- issues with the online service, with no work-round – you will need to provide the error message received.

If you believe you have a reasonable excuse you can ask for a penalty to be reconsidered. HMRC will look carefully at the information you provided and any other available evidence.

You should tell HMRC as soon as possible – do not wait until you receive the penalty.

You should write to your Tax Office with the following:

- your name and Unique Taxpayer Reference – you will find this on your tax return or statement;
- the date you sent your return; and
- the reason it was late.

HMRC cannot accept this information over the telephone.

Interest and penalties if you do not pay on time

If you miss the deadline, the longer you delay, the more you'll have to pay. So it is important to still send your payment to HMRC as soon as you can.

If, for example, you pay more than six months late, you will be asked to pay the first two penalties shown in the table below.

Penalties for paying late

Length of delay	Penalty you will be asked to pay
Thirty days	5% of the tax unpaid at that date
Six months	A further 5% of the tax unpaid at that date
Twelve months	A further 5% of the tax unpaid at that date

Interest charges if you pay late

You will have to pay interest on all outstanding amounts, including any unpaid penalties, until payment is received.

Late return and payment penalties for earlier years

In some cases, you may have to pay a penalty under the 'old rules' that applied before 6th April 2011. For example you were asked to complete a 2009/10 tax return and you still have not sent it back.

(HMRC website What's New? 6.04.11)

Further observations

This new regime introduced by FA 2009 Sch 56 first applied with effect from April 2010 to late payments under PAYE and the Construction Industry Scheme. The last I had heard was that it was expected to be applied to IHT from April 2012.

There seems nothing to suggest that it does not apply to Payments on Account under Income Tax self assessment.

13. Penalty for Failure to Disclose Offshore Income or Gains

HMRC Brief 14/11 explains how legislation in FA 2010 Sch 10 allows for a higher penalty rate where income or gains that arise outside the UK are underdeclared. People who do not declare income or gains arising offshore could face penalties that are up to 200% of the tax owed.

The new penalties for offshore non-compliance came into force on 6 April and will apply for the 2011/12 tax year onwards to Income Tax and CGT.

[See Webinar Notes February 2011 Item 15].

(Revenue & Customs Brief 14/11 6.04.11)

What is a reasonable excuse?

If you have a reasonable excuse for not complying, then the penalties for failure to notify and failure to file a return on time will not apply. The reasonable excuse must

- be an exceptional event beyond your control; and
- apply throughout the period when you failed to comply and you must notify HMRC or file the return as soon as possible after the reasonable excuse ends.

What is reasonable care?

HMRC will not charge an inaccuracy penalty if you took '*reasonable care*' to get your return or claim correct but still made a mistake. What counts as '*reasonable care*' varies depending on the person's circumstances.

Some ways you can show you took reasonable care include:

- keeping accurate records to make sure your tax returns are correct;
- checking what the correct position is when you do not understand something.

What if I disagree with the penalty?

You can ask HMRC to review a penalty or you can appeal against it to an independent tribunal. Factsheet HMRC1 explains how you can do this.

When does a capital gain arise offshore?

A capital gain can arise if you sell an asset for a profit. This is most likely if you sell property, but it could apply to land, a boat, a painting, shares, or other assets held outside the UK. CGT does not apply to some items and there are allowances that can reduce the amount.

Am I liable to tax on income abroad?

If you normally live in the UK then you are liable to UK tax on your income whether it arises in the UK or abroad. If your permanent place of residence is not the UK then you need to find out if you are resident in the UK for tax purposes.

What about the foreign tax already deducted?

If you have a bank account abroad or foreign dividends tax may be deducted in that country. If there is a Double Taxation Agreement (DTA) between the UK and the country we will often offset the foreign tax against tax due in the UK. This may mean you don't have to pay additional UK tax.

I receive rental income from abroad but don't make a profit

If you receive rental income from an overseas property you are liable to UK tax on the income. You must complete a SA return to declare this income. You can deduct certain expenses and allowances.

If you have paid foreign tax you can also claim tax relief for the tax paid.

I do not know if I am due to pay additional UK tax

If you are unsure whether you should pay UK tax on income or gains from abroad please contact HMRC with the details. It is important you do this immediately as a full disclosure, before HMRC contact you, can greatly reduce any penalty.

Where can I get more information and help?

There is information on offshore penalties on the HMRC website. If you prefer to speak to HMRC about your tax, please phone the helpline number on the tax return or letter HMRC have sent you.

(HMRC website What's New? 7.04.11)

14. HMRC Turn Up the Heat on Plumbing Industry

About 50,000 plumbers, gas fitters and heating engineers will start receiving letters this month from HMRC alerting them to the chance to take advantage of a special time-limited tax plan to put right any gaps that might exist in their tax affairs. (See Webinar Notes April 2011 Item 25.)

The letter will explain that, once the opportunity expires, the tax authorities will begin a clampdown on those working in the sector who have failed to declare earnings and pay the tax they owe.

Under the tax plan, plumbers, gas fitters, heating engineers and members of associated trades who owe tax which they have not yet declared can come forward any time up to 31 May to tell HMRC they want to take part. If they make a full disclosure, most face a low penalty rate of 10%, with a maximum of 20%. Once they come forward, they have until 31 August to make their disclosure and arrange for payment.

After that date, using information pulled together from different sources, HMRC will investigate those who have failed to come forward.

Substantial penalties or even criminal prosecution could follow.

The Plumbers' Tax Safe Plan (PTSP) is the first initiative in a campaign focused on tradespeople. It is designed to make it easy for those in the plumbing industry to put their tax affairs in order.

Mike Wells, HMRC's Director of Risk and Intelligence, said: *'Our aim is to make it easy for plumbers to contact us, make a full disclosure of income and face a reduced penalty.'*

'We are using a variety of intelligence sources to target plumbers who have not declared their full income and I urge tradespeople in this group who think they owe tax on their income to get in touch with HMRC and get their tax affairs in order simply and on the best available terms.'

'The first step for those wishing to avoid a full tax investigation with much higher penalties is to notify us.'

'We do not think everyone who receives a letter owes us tax. However, if you owe tax and don't get a letter, do not assume that HMRC will not catch up with you.'

To join the tax plan people in the plumbing industry:

- must register with HMRC to 'notify' that they plan to make a voluntary tax disclosure by 31 May; and
- then have until the 31 August to tell HMRC about tax due and make arrangements to pay any tax interest and penalties due. This is called 'making a disclosure'.

How do plumbers let HMRC know that they intend to make a tax disclosure?

- Online by completing a notification form at www.hmrc.gov.uk/plumberstaxsafeplan; or
- ring HMRC on 0845 600 4507.

A dedicated team is available to give to information and advice.

The benefit of the Plumbers Tax Safe Plan is that those who make a full disclosure:

- will be offered a simple and straightforward way to put their tax affairs right; and
- will be charged a low penalty rate – 10% for most who sign up, with a maximum rate of 20%.

(HMRC website What's New? 26.04.11)

15. Employee Benefit Trusts: Settlement Opportunity

HMRC are offering employers who have used EBTs (and similar arrangements) the opportunity to resolve outstanding enquiries. These arrangements seek to minimise the Income Tax and National Insurance charge on remuneration to employees and directors and may also generate a claim for Corporation Tax deductions for payments into the trust. The Finance (No 3) Bill 2011 published on 31 March 2011 introduced new legislation to put beyond doubt that such arrangements or schemes do not work. HMRC's view on these schemes under existing legislation was notified in Spotlight 5 and published in November 2009.

HMRC are inviting employers, companies and other users of these arrangements to settle without recourse to litigation. This will minimise costs to both taxpayers and HMRC. Employers and companies concerned with how their arrangements will be affected by the new legislation can respond to this opportunity to obtain certainty about their tax liabilities.

Employers or companies willing to reach a financial settlement with HMRC will be invited to discuss how this might be achieved. Any settlement will depend on the facts of the case, in particular whether the contributions to the trust have a link to employment or not.

Dave Hartnett, Permanent Secretary for Tax at HMRC, said today 'This initiative reflects HMRC's determination to seek to resolve disputes without going to litigation where that can be done without detriment to the Exchequer and within the clear boundaries of the law. HMRC's pro-active approach to taxpayers gives them the opportunity to discuss their cases with us and work in partnership to establish how the facts of their case fit within the proposals. For this reason I would encourage customers to come and talk to us'.

Details of initiative

In situations where HMRC consider there is a link to employment (the majority of cases) the terms on which they would be prepared to settle will depend on whether there has already been a *'relevant step'* under the new disguised remuneration legislation.

This legislation for tax is in Sch 2 to the Finance (No 3) Bill 2011, which was published on 31 March 2011. Once this is enacted, the bulk of the legislation will take the form of a new Part 7A in ITEPA 2003. This legislation also allows for provision for credit to be given against Part 7A charges in cases where there has already been a settlement in respect of the remuneration which could also give rise to the Part 7A charge. The provision for this credit is contained in para 58 of Sch 2 (rather than being included in new Part 7A).

The disguised remuneration legislation, once enacted, will have effect from 6 April 2011 and, in some cases, will apply to transactions that took place on and after 9 December 2010. HMRC's intention is to make corresponding Regulations to deal with National Insurance contributions.

Terms on which HMRC are prepared to settle

Where HMRC consider there is a link to the employment:

1. If the settlement is reached before a relevant step under the disguised remuneration legislation is taken:

- (a) recovery of outstanding PAYE and Class 1 National Insurance contributions (Earnings Basis) on contributions to the trust, with a corresponding Corporation Tax deduction where permitted under the appropriate Corporation Tax assessing provisions;
- (b) the settlement will be an agreement for the purposes of paragraph 58 of the Finance (No. 3) Bill 2011 and the employee will be entitled to a corresponding credit against the value of a subsequent relevant step under Part 7A of ITEPA provided that the sums due under the settlement have been paid; and
- (c) where a benefit-in-kind charge has arisen in connection with the amount that has been contributed (for example on a beneficial loan), the settlement terms will give credit for the benefit-in-kind charge, provided that the tax and National Insurance contributions has been accounted for.

2. If a relevant step under the disguised remuneration legislation is taken before a settlement has been reached:

- (a) where a tax and NIC charge arises as a consequence of a relevant step and the relevant step relates to an amount contributed to the trust before 6 April 2011, HMRC will not pursue recovery of PAYE and National Insurance contributions on that same amount for the earlier period;
- (b) where the relevant step does not account for the whole of the amount contributed to the trust before 6 April 2011, HMRC will continue to be willing to settle the outstanding amount on the basis described above, giving rise to a corresponding settlement credit under Part 7A for subsequent relevant steps; and
- (c) where a benefit-in-kind charge has arisen on amounts (for example on beneficial loans) for periods before the charge under Part 7A arises, HMRC will not give credit for the benefit-in-kind charge.

EBTs where there is no link with employment

In situations where HMRC consider there is no link to employment (anticipated to be a minority of cases):

- HMRC will deny a Corporation Tax deduction;
- amounts will not be subject to PAYE and National Insurance contributions at the point HMRC deny the Corporation Tax deduction;
- however, this will not prevent a subsequent tax charge under of ITEPA 2003 s62 or new Part 7A from applying at some point in the future if a later taxable event happens; and
- if a subsequent tax charge does arise, provided one is due, a Corporation Tax deduction will be permitted at that time.

Other practical issues

Interest will be charged on duties in the normal way.

The settlement will take into account all relevant duties. HMRC published a Revenue and Customs Brief 18/11 on 4 April 2011 that sets out the circumstances where Inheritance Tax and non-resident trust charges are due on EBT.

Resolving these enquiries will depend on examination of the facts of individual cases. HMRC will write to all employers or companies who have open EBT enquiries before the end of August 2011 to invite discussion about potential settlements and provide contact details for the HMRC officer dealing with a case. HMRC have put arrangements in place to ensure that a consistent approach is taken to agreeing settlements.

There is no deadline for the incentive, but if employers or companies do not respond by 31 December 2011, HMRC will assume that they are not interested in engaging with them and will look to progress enquiries formally.

HMRC will continue to enquire into open EBT cases and may open further enquiries during this period including seeking further information.

Where HMRC are unable to agree settlement proposals with employers or companies, then they will, as appropriate, continue to progress cases within the terms of the published Litigation and Settlement Strategy, and the new legislation will apply to continuing EBTs, and funds held in them.

(HMRC website What's New? 20.04.11)

Further observations

The general professional comment on this HMRC initiative is that it is fairly underwhelming and not likely to attract many takers, in that there really seems to be no incentive to adopt it.

16. Equitable Liability Replaced by a New Statutory Special Relief

Background

Previously, where taxpayers had no statutory remedy to adjust an excessive assessment or displace a determination because the time limit for submitting a return

had passed, HMRC would in some cases be prepared not to pursue their legal right to recover the full amount due. This practice was known as '*equitable liability*'. The purpose of the equitable liability concession was to provide a 'relief of last resort' for certain taxpayers, particularly those vulnerable taxpayers who are unable to fully engage with the tax system, for a number of different reasons.

From 1 April 2011, equitable liability has been replaced by a new, statutory, special relief. HMRC have now published this guidance to officers regarding the new relief.

The new relief

HMRC's guidance on the new relief can be found here new Self Assessment Claims manual guidance. The guidance will be incorporated in HMRC SA Claims Manual shortly.

HMRC will no longer accept new requests for equitable liability, but will still continue to consider those claims for equitable liability received before that date.

Timing

All of the changes outlined in HMRC Brief 17/11 take effect from 1 April 2011.

SACM12220 - Overpayment relief – Special relief: what is covered

Special relief is a form of overpayment relief which can only apply to amounts charged in HMRC determinations for Income Tax SA or Corporation Tax SA where no other statutory remedy is available. Claims can be made on or after 1 April 2011.

Determinations

A person (individual or company) who has received a notice to make a return must do so by the filing date. When a person fails to meet this obligation, HMRC have the power to raise a determination of the liability due and unpaid to the best of their knowledge and the information available to them. Where HMRC issue, such a determination the sum on it becomes the amount that is legally due to be paid. There is no right of appeal against a determination. But submission of the return will displace the determination and the determined amount of tax will be automatically amended to the return amount, provided the return is received within the time allowed. See SAM121080 and COM23170 for the relevant time limits.

If these time limits are passed a person may, subject to what follows, claim special relief, if HMRC have made a determination in the absence of a return for a year of assessment or accounting period and:

- the person is out of time to make a return to displace the determination; and
- they are unable to claim overpayment relief.

Unlike claims to overpayment relief, there is no time limit for claiming special relief

Also unlike overpayment relief claims, special relief is not automatically excluded whenever:

- a person knew, or ought reasonably to have known, that they had some other means of correcting an overpayment or over-assessment, but they failed to use those other means within the relevant time limit. [Case C – see SACM12085]; or
- HMRC have already taken court action to recover amounts due under a determination [Case F - see SACM 12100], unless the person was present or was legally represented during the proceedings, or an agreement was reached to settle the proceedings.

In addition to the above, the person making a claim for special relief must satisfy both the remaining requirements for overpayment relief and must meet three further conditions which reflect HMRC's former practice regarding equitable liability – see SACM12230.

SACM12230 – Overpayment relief – Special relief: further conditions

There are three particular conditions which must be met for special relief to be available. These reflect HMRC's former practice in applying equitable liability. The conditions are:

A – In the opinion of the Commissioners it would be unconscionable for HMRC to seek to recover the amount which has been charged by a determination, or refuse to repay it if it has already been paid.

B – The person's tax affairs are otherwise up to date or arrangements have been made to the satisfaction of the Commissioners, to bring them up to date as far as possible.

C - The person has not previously claimed special relief or sought equitable liability – whether or not relief was given.

Condition C may be disregarded in exceptional circumstances.

Any claim for special relief must include such information and documentation as is reasonably required to determine whether these conditions are met.

Enforcement Insolvency Service (EIS) are responsible for determining whether a claim to special relief can be accepted and in particular whether these three conditions are met.

SACM12270 - Overpayment relief – Special relief: penalties, surcharges and interest

Fixed penalties for late delivery of an SA return are still payable following a claim for the relief but for years up to 2009/10, for which the penalty is capped to the total amount of the tax chargeable where it is less than £100, the penalty will be revised to reflect the amount of tax due after the relief has been applied.

Any daily penalties imposed for non-delivery of an SA return are also not disturbed by a claim for relief even when the revised tax is reduced to nil.

These penalties will continue to be due in fairness to those customers who have complied with their tax obligations within the statutory time limits.

If, after the relief is given and the taxpayer maintains that any daily penalties still payable are disproportionate to the amount payable, then the dispute must be dealt with as a separate matter by the DMB office that has collection responsibility for the case.

Surcharges and interest will also be reduced to reflect the amount of tax due after the relief has been applied.

(HMRC website What's New? 1.04.11)