Tax update

March 2018

In this month's update we report on HMRC's recently published guidance on the Serial Tax Avoidance Regime; venture capital schemes; and non-domicile reforms. We also comment on three recent cases relating to discovery assessments; closure notices; and set-off of corporation tax losses against general income.

News items

HMRC publishes guidance on the Serial Tax Avoidance Regime

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HMRC updates guidance on Venture Capital Schemes

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HMRC publishes guidance on non-domicile reforms

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Case reports

Cooke – Tribunal allows taxpayer's appeal against discovery assessment

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Beneficial House – Tribunal orders HMRC to issue closure notices

In *Beneficial House (Birmingham) Regeneration LLP and Stanley Dock (All Suite) Regeneration LLP v HMRC* [2017] UKFTT 0801 (TC), the FTT directed HMRC to issue closure notices in respect of HMRC's ongoing enquires into the taxpayers' returns in which they had claimed Business Premises Renovation Allowance (BPRA) in respect of certain hotel conversions. more›

English Holdings – Tribunal allows set-off of corporation tax loss against general income

In *English Holdings Ltd v HMRC* [2016] UKFTT 0346 (TC), the Upper Tribunal (UT) has upheld a decision of the FTT which allowed an appeal by a non-UK resident company against a decision of HMRC refusing its claim to set off losses arising in its UK permanent establishment (PE) against profits earned by its UK property rental business. more›

Any comments or queries

Adam Craggs
Partner
+44 20 3060 6421
adam.craggs@rpc.co.uk

David Gubbay
Partner
+44 20 3060 6050
david.gubbay@rpc.co.uk

Robert Waterson
Legal Director
+44 20 3060 6245
robert.waterson@rpc.co.uk

Michelle Sloane
Senior Associate
+44 20 3060 6255
michelle.sloane@rpc.co.uk

About this update

The Tax update is published on the first Thursday of every month, and is written by members of RPC's Tax team.

We also publish a VAT update on the final Thursday of every month, and a weekly blog, RPC's Tax Take.

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News items

HMRC publishes guidance on the Serial Tax Avoidance Regime

On 12 January 2018, HMRC published guidance on the Serial Tax Avoidance Regime legislation contained in Schedule 18, Finance Act 2016.

The guidance closely follows the legislation and indicates how HMRC intend to operate the regime in practice. The following examples in the guidance are helpful:

- examples illustrating the penalty aggregation rules and the application of the cap in the follower notice regime (paragraph 5.3)
- examples illustrating the value of the counteracted advantage where additional tax is due (ignoring group relief), where the intended effect of the arrangement is to create or increase a loss, where payment of tax is deferred and where the arrangement relates to VAT (paragraphs 5.5 to 5.8)
- examples illustrating the effects of warning notices having been issued to a company before it joins a group (paragraph 7.3) and illustrating the application of the rules to corporate groups that are also VAT groups (paragraph 7.5).

A copy of the guidance can be viewed here.

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HMRC updates guidance on Venture Capital Schemes

On 21 December 2017, HMRC updated its Venture Capital Schemes Manual.

The amendments reflect, in relation to the Enterprise Investment Scheme and the Seed Enterprise Investment Scheme, statements made in HMRC's response paper to the consultation on streamlining the advance assurance service for venture capital schemes

The guidance indicates that HMRC will not respond to requests for assurances in relation to hypothetical or speculative applications. Any applications must name the individuals who are to make the relevant investments and promoters.

A copy of the guidance can be viewed here.

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HMRC publishes guidance on non-domicile reforms

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A copy of the guidance can be viewed here.

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Case reports

Cooke – Tribunal allows taxpayer's appeal against discovery assessment

In *Cooke v HMRC* [2017] UKFTT 844 (TC), the First-tier Tribunal (FTT) has allowed an appeal against a discovery assessment issued by HMRC pursuant to section 29, Taxes Management Act 1970 (TMA). The FTT found that the "hypothetical officer" could have been reasonably expected to be aware that certain claims in the taxpayer's return were excessive.

Background

The taxpayer claimed relief from double taxation, in respect of foreign dividends from three jurisdictions, two of which were France and Canada, in his tax returns for the 2012/13 and 2013/14 tax years. The 2012/13 return was filed electronically on 22 January 2014 and under section 9A(2)(a), TMA, HMRC had until 22 January 2015 to open an enquiry. No enquiry was opened within this time limit. The taxpayer's 2013/14 return was filed electronically on 17 November 2014.

HMRC opened an enquiry into the 2013/14 return on 24 September 2015. HMRC concluded that the French and Canadian dividends were excessive, being more than the 15% permitted by the relevant double tax treaties with France and Canada.

HMRC's enquiry into the 2013/14 return led to it to consider the 2012/13 return and forming the same conclusion. As HMRC was out of time to open an enquiry into the 2013/14 return, it issued a discovery assessment to the taxpayer pursuant to section 29, TMA.

The taxpayer appealed to the FTT.

FTT decision

The appeal was allowed.

The issue for the FTT to determine was whether either or both of the conditions in section 29(4) (that the loss of tax was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf) or (5) (at the time the officer ceased to be entitled to give notice of intention to enquire into a taxpayer's return the officer could not have been reasonably expected, on the basis of the information available to him, to be aware of the loss of tax), were satisfied.

HMRC submitted that section 29(4) was satisfied because the taxpayer's accountant had been careless in not checking the correct relief rate available. HMRC also submitted that section 29(5) was satisfied as the return did not disclose adequate or sufficient information to alert the 'hypothetical officer' to a loss of tax.

The taxpayer argued that his accountant, a general practitioner without specialist knowledge, should not be considered to be careless when relying on computer software to complete his return and the return did contain sufficient information to alert the "hypothetical officer" to the loss of tax claimed by HMRC.

The FTT preferred the taxpayer's arguments.

With regard to section 29(4), the FTT said that in determining what constitutes carelessness for the purposes of the subsection, all relevant circumstances must be taken into consideration. The taxpayer's accountants were a small firm with no tax specialists. They relied, like many firms, on software to complete their clients' returns and HMRC encouraged this. It was, therefore, reasonable for the accountants to rely on the software used.

In relation to section 29(5) and relying on *Charlton v HMRC* [2013] STC 866, the FTT confirmed that the test in section 29(5) was whether a hypothetical HMRC officer could have been reasonably expected to be aware that the relief claimed was excessive. In the circumstances, the FTT concluded that a hypothetical officer could have been reasonably expected to be aware that the relief claimed was excessive as the percentages claimed were clear from the figures in the return and the tax in question was not complex. A white space entry was not required, and any HMRC officer of general competence, knowledge or skill, would have some understanding of double tax relief, including that there are limitations on the relief that can be claimed.

Comment

HMRC increasingly seeks to use its discovery assessment powers when it is out of time to open an enquiry. Taxpayers are entitled to certainty in their tax affairs and indeed that was the quid pro quo when self-assessment was introduced. There can be a tendency for HMRC to issue discovery assessments as a "get out of jail" card when they would otherwise be out of time to open an enquiry and this decision is a timely reminder that certain conditions must be satisfied before HMRC is able to issue a valid discovery assessment.

Interestingly, the FTT said that HMRC's internal processes are irrelevant when considering section 29. The fact that HMRC's "process first, check later" approach meant it did not identify the mistake until relatively late was irrelevant. The FTT commented:

"It may well be that s 29(5) does not fit as well as HMRC might like with their current working practices, and in particular the electronic processing of returns, but that is no basis for interpreting the provision in a way that does not accord with what it actually says."

A copy of the decision can be viewed here.

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Beneficial House – Tribunal orders HMRC to issue closure notices

In *Beneficial House (Birmingham) Regeneration LLP and Stanley Dock (All Suite) Regeneration LLP v HMRC* [2017] UKFTT 0801 (TC), the FTT directed HMRC to issue closure notices in respect of HMRC's ongoing enquires into the taxpayers' returns in which they had claimed Business Premises Renovation Allowance (BPRA) in respect of certain hotel conversions.

Background

Beneficial House (Birmingham) Regeneration LLP and Stanley Dock (All Suite) Regeneration LLP (the taxpayers) were property developers. The taxpayers claimed BPRA in respect of hotel conversions carried out in Birmingham and Liverpool.

The arrangements were the subject of notifications to HMRC under the Disclosure of Tax Avoidance Schemes (DOTAS) regime, contained in Part 7, Finance Act 2004.

Stanley Dock submitted its partnership return for 2011/12, claiming BPRA in the sum of £26,109,339. HMRC opened an enquiry into the return in March 2013. Beneficial House submitted its partnership return for 2012/13, claiming BPRA in the amount of £14,651,000. HMRC's enquiry into its return was opened in January 2014.

HMRC's enquiries proceeded slowly and investors in both Stanley Dock and Beneficial House received Partner Payment Notices under the Accelerated Payment Notice legislation contained in Part 4 and Schedule 32, Finance Act 2014.

The taxpayers applied to the FTT, pursuant to section 28B(7), TMA, for a direction that HMRC be directed to close its enquiries within three months (the Application).

FTT decision

The Application was granted.

In coming to its decision, the FTT sought to balance the need for HMRC to be in a position to make an informed judgement of the extent of any disallowance of the claims and any other adjustments to the returns with other factors, such as the length of the enquiry and the significance of the outstanding requests for information.

The FTT noted that enquiries in both cases were relatively lengthy, which in principle increased the burden on HMRC to demonstrate why the FTT should not direct that closure notices be issued. The fact that HMRC considered tax avoidance arrangements had been implemented did not, of itself, justify an extension of its enquiries.

With regard to the outstanding information requests, as a result of agreement reached between the parties at the hearing in relation to the provision of further documents, the FTT noted that it should be the case that all outstanding information requests would be met. The dates set by the FTT for the issue of closure notices would allow all outstanding information requests to be dealt with.

The FTT commented that there is a distinction between obtaining information and documents which should, if possible, be dealt with during the enquiry stage, and undertaking all the detailed analysis that HMRC would like to undertake. The FTT said:

"Whilst it is clearly desirable that HMRC develop a clear position which can be expressed both in the closure notices and in their Statements of Case, that needs to be balanced with the need to avoid the enquiries being unnecessarily protracted. I have endeavoured to ensure that HMRC are given adequate time to review the responses to express an informed judgment, even if they have not fully completed their analysis. I also do not think that it is reasonable for the closure of the enquiries to be delayed for reasons that are wholly related to HMRC's internal working practices, for example in respect of the time said to be required to obtain valuation input".

Comment

HMRC enquiries can be long and drawn out, often lasting many years and in circumstances where HMRC is able to issue APNs to taxpayers (as in this case) there is little incentive for HMRC to conclude its enquiries in a timely manner. When a taxpayer considers HMRC has sufficient information to close its enquiry but it is refusing to do so, consideration should be given to whether it is appropriate to apply to the FTT for a direction requiring HMRC to close its enquiry within a specified period of time.

A copy of the decision can be viewed here.

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English Holdings – Tribunal allows set-off of corporation tax loss against general income

In *English Holdings Ltd v HMRC* [2016] UKFTT 0346 (TC), the Upper Tribunal (UT) has upheld a decision of the FTT which allowed an appeal by a non-UK resident company against a decision of HMRC refusing its claim to set off losses arising in its UK permanent establishment (PE) against profits earned by its UK property rental business.

Background

English Holdings Limited (EHL) is a company registered in the British Virgin Islands and is non UK resident. It trades in UK land through a PE in the UK.

Any profits made through the PE would be subject to corporation tax by virtue of sections 5(3) and 19, Corporation Taxes Act 2009 (CTA), but it in fact made a loss in excess of £2m.

EHL also owned a number of investment properties in the UK, from which it earned rental income. This letting business was not carried on through a PE, so that it was within the charge to UK income tax on any profits arising from the business under section 264, Income Tax (Trading and Other Income) Act 2005. In 2009/10, the letting business made a profit of over £1m.

EHL made a claim to set-off the loss incurred by its UK PE against the profits of its letting business. The effect of the set-off would be to reduce its income tax liability to nil.

HMRC rejected the claim and EHL appealed.

FTT decision

The appeal was allowed.

The issue before the FTT was whether a corporation tax loss could be set-off against an income tax profit.

EHL relied on section 64, Income Tax Act 2007 (ITA), which provides:

"64 Deduction of losses from general income
(1) A person may make a claim for trade loss relief against general income if the person –
(a) carries on a trade in a tax year, and
(b) makes a loss in the trade in the tax year ('the loss making year')."

HMRC accepted EHL had "carried on a trade" and made a loss in the relevant year. However, it did not accept that the relief was available due to section 5, ITA, which provides:

"5 Income tax and companies

Section 3 CTA 2009 disapplies the provisions of the Income Tax Acts relating to the charge to income tax in relation to income of a company … if –
(a) the company is UK resident, or
(b) the company is not UK resident and the income is within its chargeable profits as defined by section 19 of the Act (profits attributable to its permanent establishment in the United Kingdom)".

HMRC argued that section 3, CTA, disapplied the income tax provisions, including the calculation of losses, if profits from the trade were chargeable to corporation tax.

The FTT was not persuaded by HMRC's argument. Although the legislation limits the scope of the charges to tax in circumstance where profits are taxed, the provisions relied on make no mention of losses. The FTT held that on a literal interpretation of the legislation, the loss relief provisions contained in section 64, ITA, could be utilised by EHL to set-off the corporation tax loss against the profits of its letting business.

HMRC appealed.

UT decision
The appeal was dismissed.

HMRC maintained its argument that section 3, CTA, has the broad effect of separating the corporation tax regime from the income tax regime so that where a trade is within the corporation tax regime then its profits and losses are dealt with exclusively under the corporation tax regime and cannot fall within the income tax regime, either for the purpose of being taxed as income if the trade makes a profit or for the purpose of claiming loss relief if the trade makes a loss.

The UT rejected this argument. In the view of the UT, there is nothing in section 64, ITA, which limits the trade in which the loss is made to a trade which, if profitable, is chargeable to income tax. Section 3, CTA, only disapplies those provisions of the ITA which apply to the income of a non-resident company where the income is within its chargeable profits as defined by section 19, CTA. Further, there was no obvious reason why Parliament would have intended that taxpayers would not be able to set a loss from one trade against the profit from another.

The UT concluded that on a proper construction of the relevant provisions of ITA and CTA, EHL was entitled, pursuant to section 64, ITA, to set-off the losses incurred in its PE trade against the profits of its letting business.

Comment
This case raises some interesting questions regarding the interaction between income tax and corporation tax. The tax tribunals have in recent years frequently adopted a purposive approach to the interpretation of tax legislation, often in the context of appeals by taxpayers who have participated in tax planning arrangements. It is interesting to note that on this occasion they chose not to adopt such an approach.

It remains to be seen whether HMRC will seek to appeal to the Court of Appeal, but as UK property income of non-resident companies will be charged to corporation tax, rather than income tax, from April 2020, it may feel there is no need to appeal the decision.

A copy of the decision can be viewed here.

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About RPC

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18028

Tower Bridge House
St Katharine's Way
London E1W 1AA
T +44 20 3060 6000

Temple Circus
Temple Way
Bristol BS1 6LW
T +44 20 3060 6000

11/F Three Exchange Square
8 Connaught Place
Central Hong Kong
T +852 2216 7000

12 Marina Boulevard
#38-04 Marina Bay Financial Centre Tower 3
Singapore 018982
T +65 6422 3000