RPC

Tax update

October 2016

In this update we report on the Worldwide Disclosure Facility recently announced by HMRC, new sanctions for failure to register, and the latest Spotlights published by HMRC. We also comment on some recent tax decisions relating to industrial buildings allowance, offsetting losses arising in a UK permanent establishment against profits earned by its UK business and opting out of the costs regime.

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Worldwide disclosure facility

HMRC has published a consultation on the introduction of a requirement for taxpayers to disclose and pay any outstanding tax liabilities relating to offshore interests by 30 September 2018. more›

New sanctions for failure to register

HMRC has launched a consultation on proposed enhanced penalties for those who evade tax by failing to register for tax or concealing sources of income by non-inclusion on a tax return. This approach forms part of HMRC's general strategy for cracking down on the "hidden economy". more›

Spotlights on income to capital gain scheme

HMRC has published a new Spotlights update on a scheme designed to turn income into capital gains for the purposes of benefiting from Entrepreneurs' Relief. more›

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Wellstead – Tribunal finds in taxpayer's favour in IBA case

In *David Wellstead v HMRC*[1], the First-tier Tribunal (FTT) has held that where a developer acquired a lease of land, constructed industrial units on that land and sold one of the units by way of an under-lease, the grant of the under-lease amounted to the sale of a relevant interest for the purposes of section 296, Capital Allowances Act 2001 (CAA 2001), entitling the purchaser to claim industrial buildings allowances (IBAs) on the purchase price. more›

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

In *English Holdings Ltd v HMRC*[2], the FTT allowed an appeal by a non-UK resident company against a decision of HMRC refusing its claim to offset losses arising in its UK permanent establishment (PE) against profits earned by its UK property rental business. more›

Any comments or queries

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About this update

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

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

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N Brown Group Plc – Tribunal confirms there is no going back once a taxpayer has opted out of the costs regime

In *N Brown Group Plc and Another v HMRC*[3], the FTT, has confirmed that it did not have the power to permit a taxpayer to withdraw its written request that the proceedings be excluded from the costs regime. more>

News items

Worldwide disclosure facility

HMRC has published a consultation on:

- the introduction of a requirement for taxpayers to disclose and pay any outstanding tax liabilities relating to offshore interests by 30 September 2018
- a new set of sanctions for those with outstanding tax liabilities who fail to meet this deadline.

The definition of an offshore interest is taken from existing legislation of an offshore matter and an offshore transfer (paragraphs 4A(4) and 4AA(2)-(8), Schedule 24, Finance Act 2007). The scope of the requirements is broad and aims to "compel those with offshore interests who have yet to put their UK tax affairs in order to do so by September 2018". Following this date the adoption of the Common Reporting Standard by over 100 countries will lead to a significant increase in the amount of information available to HMRC regarding taxpayers and the assets they hold offshore. The consultation includes detailed proposals for the penalty regimes which may operate.

The consultation closes on 19 October 2016.

A copy of the consultation document can be found here.

New sanctions for failure to register

HMRC has launched a consultation on proposed enhanced penalties for those who evade tax by failing to register for tax or concealing sources of income by non-inclusion on a tax return. This approach forms part of HMRC's general strategy for cracking down on the "hidden economy".

The consultation closes on 21 October 2016.

A copy of the consultation document can be found here.

Spotlights on income to capital gain scheme

HMRC has published a new *Spotlights* update on a scheme designed to turn income into capital gains for the purposes of benefiting from Entrepreneurs' Relief.

The scheme works by individuals selling the beneficial ownership of their company to entities based in Cyprus. They then become employed by that entity. The individual remains a director of their company which continues to invoice for their services (even though they are now employed by the entity in Cyprus).

The monthly payments are then stated to be taxable as a capital gain at 10% (following an Entrepreneurs' Relief claim) rather than employment income.

HMRC considers the scheme does not work as it considers the arrangements "to be highly contrived" and involving a "number of artificial steps".

A copy of *Spotlights* can be found here.

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Case reports

Wellstead – Tribunal finds in taxpayer's favour in IBA case

In *David Wellstead v HMRC*[1], the First-tier Tribunal (FTT) has held that where a developer acquired a lease of land, constructed industrial units on that land and sold one of the units by way of an under-lease, the grant of the under-lease amounted to the sale of a relevant interest for the purposes of section 296, Capital Allowances Act 2001 (CAA 2001), entitling the purchaser to claim industrial buildings allowances (IBAs) on the purchase price.

Background

Mr Wellstead (the Appellant), was a director of Hillford Construction Limited (HCL). In 2001, HCL purchased a 125 year lease of land at an industrial park and developed two industrial units on the land. In 2004, HCL granted an under-lease of one of the units to the Appellant. The under-lease was for the same term as HCL's lease less 5 days. The Appellant paid a premium of £1m for the under-lease.

The Appellant claimed IBAs on the purchase price in the sum of £840,880, pursuant to section 290, CAA 2001.

HMRC refused the claim on the basis that the under-lease was not the sale of "the relevant interest", for the purpose of section 296, CAA 2001.

HMRC was of the view that the legislation only permits IBAs to be claimed where the purchaser purchases the same interest as was held by the developer at the time the buildings were built. The Appellant would therefore only be entitled to IBAs if he had taken an assignment of the lease. As the Appellant had acquired an under-lease, he was not entitled to IBAs.

The Appellant's position was that the legislation was designed, amongst other things, to encourage expenditure in enterprise zones by granting IBAs to those incurring expenditure on buildings in enterprise zones. He had incurred such expenditure and in the context of that overriding purpose, there was no policy reason or rationale for a distinction between the lease and the under-lease. A realistic and purposive construction of the provisions should therefore be adopted.

Importantly, the Appellant also relied on the terms of section 288(1), CAA 2001, which provided that:

"An interest does not cease to be the relevant interest merely because of the creation of a lease or other interest to which that interest is subject" (emphasis added).

Section 288(1) refers to the position where a lease or other subordinate interest is created to which the relevant interest is subject. The effect of this subsection was that the grant of a subordinate interest will not, on its own, cause an interest to cease to be a relevant interest. It depended on the circumstances of the individual case whether the grant of a subordinate interest would cause an interest to cease to be the relevant interest.

1. [2016] UKFTT 0492 (TC).

FTT's decision

The FTT agreed with the Appellant that the legislation did not specify when the granting of a sub-lease would cause the relevant interest to cease to exist as it was a matter of degree. The legislation was not prescriptive of all of the circumstances in which a grant might amount to the transfer of the relevant interest.

The FTT noted that the sale could have been completed in either one of two ways (1) the grant of a sub-lease or (2) an assignment of the lease itself. In both instances, the taxpayer would pay the same consideration. This suggested that there was no commercial difference between the lease and the under-lease.

HMRC was unable to direct the FTT to any policy reason as to why IBAs should be available to the assignee of a head-lease but not to a purchaser of the whole of a sub-lease, less a few days.

The FTT therefore accepted the Appellant's submission that the grant of the under-lease satisfied the statutory description of a sale of the relevant interest, for the purpose of section 296, and therefore qualified for IBAs.

The appeal was allowed.

Comment

HMRC regularly argues that a purposive interpretation should be adopted when construing fiscal legislation, especially in the context of tax avoidance arrangements which it disapproves of. However, on this occasion, in order to deny the claim for IBAs, it suited it to argue that the legislation was highly prescriptive. It was clearly the intention of the parties that the Appellant enjoy the same rights over the land as HCL and as the legislation was designed to encourage expenditure in enterprise zones, the FTT was not prepared to construe it in the narrow technical sense advocated by HMRC.

Although this decision will be welcomed by taxpayers, as it depended to a large extent on one ambiguous word contained in section 288(1), CAA 2001, it would not be surprising if HMRC seek to appeal the decision to the Upper Tribunal.

A copy of the decision can be found here.

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

In *English Holdings Ltd v HMRC*[2], the FTT allowed an appeal by a non-UK resident company against a decision of HMRC refusing its claim to offset losses arising in its UK permanent establishment (PE) against profits earned by its UK property rental business.

Background

English Holdings Limited (the Appellant) is a company registered in the BVI. It had a PE in the UK through which it traded in land.

Any profits made by the PE would be subject to corporation tax by virtue of sections 5(3) and 19, Corporation Taxes Act 2009 (CTA). It had however made a trading loss of over £2m.

2. [2016] UKFTT 0346 (TC).

The taxpayer also owned a number of investment properties in the UK, from which it earned rental income. This letting business was not carried out through a PE, so that it was within the charge to UK income tax on the profits arising from the business under section 264, Income Tax (Trading and Other Income) Act 2005 (ITTOIA).

The Appellant 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 the taxpayer's income tax liability to nil.

HMRC opened an enquiry into the relevant returns and in due course issued a closure nature rejecting the claim. The Appellant appealed.

FTT's decision

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

The Appellant argued that it was entitled to the relief claimed:

- on an ordinary reading of the relevant statutory provisions; and
- because of the application of the Treaty on the Functioning of the European Union, in particular, the right to the free movement of capital.

The Appellant 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 that the Appellant had 'carried on a trade' and made a loss in the relevant year. However, it did not accept that the relief was due owing 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 this 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. In the view of the FTT, on a literal interpretation of the legislation, the loss relief provisions contained in section 64, ITA, could be utilised by the Appellant to offset income tax profits.

HMRC raised a further argument relating to the Appellant's claim to set off the trading loss against profits of the same or preceding tax year. It argued that there was no basis period for income tax purposes and, therefore, no loss capable of set off. The FTT also rejected this argument. As the trade had not been started or discontinued in the tax year, the basis period was, by default, the accounting period ending in the tax year (section 198, ITTOIA).

The Appellant's appeal was therefore allowed. As the FTT allowed the appeal on the basis of statutory construction, it was not necessary for it to consider the EU law ground of appeal.

Comment

This case raises some interesting questions regarding the interaction between income tax and corporation tax in certain circumstances. HMRC had argued that the legislation indicated that Parliament had intended that the regimes for income and corporation tax should be treated as distinct and exclusive. For example, the time periods are different: tax years versus accounting periods. The FTT was not persuaded by this argument. Parliament could have legislated to ensure that corporation tax losses could not be set against income tax profits, but it had chosen not to do so. It was not therefore necessary to adopt a purposive interpretation of the legislation as advocated by HMRC.

It remains to be seen whether HMRC will appeal the decision or simply seek to have the legislation amended.

A copy of the decision can be found here.

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N Brown Group Plc – Tribunal confirms there is no going back once a taxpayer has opted out of the costs regime

In *N Brown Group Plc and Another v HMRC*[3], the FTT, has confirmed that it did not have the power to permit a taxpayer to withdraw its written request that the proceedings be excluded from the costs regime.

Background

The Appellants' appeals came before the FTT for a case management hearing. The relevant issue, for the purpose of this update, was whether the Appellants could withdraw their written requests to the FTT that the proceedings should be excluded from potential liability for costs under Rule 10(1) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the Tribunal Rules).

The Appellants' appeals had been allocated as Complex by the FTT. Under Rule 10(1)(c), the FTT may make an order in respect of costs in cases where:

"the taxpayer … has not sent or delivered a written request to the Tribunal, within 28 days of receiving notice that the case had been allocated as a Complex case, that the proceedings be excluded from potential liability for costs …".

Notwithstanding that they had opted out of costs some considerable time previously, the Appellants wrote to the FTT on 2 March 2016, seeking to withdraw their requests that the proceedings should be excluded from liability for costs, noting that HMRC had filed its Statement of Case on the (mistaken) understanding that the costs regime applied.

3. [2016] UKFTT 445 (TC).

FTT's decision

The FTT refused the Appellants' application.

At the hearing, both parties referred to the comments of the Upper Tribunal in *Atlantic Electronics Ltd v HMRC*[4], where the underlying purpose of the rule had been set out as follows:

> "The right to opt out under Rule 10 has to be exercised, as I have mentioned, within 28 days of the allocation of the case as a Complex case. There are I think, two related reasons for that requirement. The first is to achieve certainty for both parties so that they know, at an early stage, which costs regime is to apply and can run their cases accordingly. The second is to prevent the taxpayer from waiting to see how his case progresses…".

The Appellants argued that they should be allowed to withdraw their written requests to opt-out of the costs regime for three reasons. Firstly, the costs regime is the default position in a Complex case. Secondly, the taxpayer alone has a right to opt out of the costs regime and this is not dependent on the agreement of HMRC and thirdly, there is nothing in the Tribunal Rules which explicitly prevents a taxpayer from withdrawing a written request to opt out of the costs regime.

The Appellants submitted that the FTT had power to allow a taxpayer to withdraw a written request to opt out under Rule 5(3)(c) of the Tribunal Rules, which provides that the FTT may "permit or require a party to amend a document".

The FTT referred to the policy reasons which underlie the costs rules and that the ability to opt out of the costs regime under Rule 10(1)(c)(ii) is a one off event available for a limited period only (28 days from receiving notification of Complex allocation from the FTT). The FTT commented:

> "there are good reasons for that as Warren J pointed out in Atlantic Electronics. It achieves certainty for the parties and prevents a taxpayer from obtaining an unfair advantage in relation to costs by waiting to see how the case progresses before deciding whether or not to opt out …".

The FTT said that it had to decide two questions. First, did it have the power to permit an appellant to withdraw a request to opt-out of the costs regime and second, if it did have such a power, should it permit the Appellants to do so in this case.

The FTT concluded that Rule 5(3)(c) did not give it the power to permit the Appellants to withdraw their written requests to opt out of the costs regime. In the FTT's view, reference to "document" meant a document which is used in the proceedings such as a pleading, application, or submission. However, even if the written request was a "document" for the purpose of Rule 5(3)(c), the FTT agreed with HMRC's submission that the Appellants were not asking to amend their requests to opt out of the costs regime but rather to revoke the requests entirely. The FTT derived support for its approach from the fact that Rule 17 of the Tribunal Rules specifically provides that a party who has given written notice of withdrawal of their case may apply to the FTT for the case to be re-instated ie to revoke the notice, which strongly suggests that the absence of such a provision in Rule 10 is a deliberate choice. The Appellants did not seek to rely on any other provision of the Tribunal Rules and the FTT could not identify a Rule that would allow the FTT to permit the Appellants to withdraw their request to opt out of the costs regime.

4. [2012] UKUT 45 (TCC).

Comment

The FTT's conclusion that it does not have the power to allow a withdrawal of a previously notified opt out from the cost regime in a Complex appeal is not surprising given the reasoning behind the operation of the costs rules, as explained in the *Atlantic Electronics* case. This decision does, however, provide a reminder to taxpayers that when a case is notified as being Complex by the FTT, careful consideration is required in deciding whether to remain within the costs regime or not. A decision to opt out cannot be revisited at a later date.

A copy of the decision can be found here.

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About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 79 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

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