Tax update

December 2015

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In *Clive Bowring and Juliet Bowring v HMRC*, the Upper Tribunal (UT) has allowed the taxpayers' appeal and concluded that a scheme, designed to reduce capital gains tax due on capital payments made by a trust, was effective. more›

Any comments or queries?

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News

Small Business Research & Development Relief

HMRC has published a summary of the responses to its consultation earlier this year on improving access to R&D reliefs for small businesses.

One of the main responses to the consultation was that HMRC should focus on improving awareness and understanding of reliefs, rather than modifying policy design. In response, HMRC intends to launch an advance assurance service for the benefit of companies seeking to claim relief for the first time where the turnover of the enterprise is under £2m per year and it has fewer than 50 employees. An assurance will provide three years of relief for R&D claims without the risk of enquiry.

The Consultation Outcome Document can be read here.

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Consultation on Changes to the Deductibility of Interest for Companies

The Government has recently launched a consultation on amending the UK's interest deductibility rules for companies.

The consultation follows the OECD's recommendations as part of the Base Erosion and Profit Shifting (BEPS) project.

In line with those recommendations, it is proposed that a company's net interest deductions be limited to a fixed ratio of its profits with an entity exceeding the fixed ratio being permitted to deduct interest expense up to its group's ratio of net third party interest to EBITDA, if that is higher.

These recommendations, if implemented, could have serious implications for industries which are highly leveraged.

Those wishing to contribute to the consultation have until 14 January 2016 to do so.

The consultation can be read here.

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What Now for Taxpayers North of the Border?

HMRC has published its technical note on the status of Scottish taxpayers. The note includes a "Scottish Taxpayer Test" and an explanation as to the meaning of "place of residence".

Additionally, HMRC has published information on the Scottish rate of income tax, and a guide to assist people to ascertain whether they will pay the Scottish rate of income tax.

The notes clear up some common misconceptions about the new tax regime. In particular, if a person lives outside of Scotland they will not be a Scottish taxpayer even if they regard themselves as being Scottish, work in Scotland and receive a salary from a Scottish employer.

The technical note can be read here.

Information on the Scottish rate of income tax can be read here.

The guide to whether the Scottish rate of income tax is payable can be read here.

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Cases

Tribunal allows private residence relief

In the recent case of *Richard James Dutton-Foreshaw v HMRC*[1], the First-tier Tribunal (FTT) held that Mr Dutton-Foreshaw (the Appellant) was entitled to claim principal private residence relief (PPR) under section 222 Taxation of Chargeable Gains Act 1992 (TCGA), despite only having lived in the property concerned for seven weeks.

Background

The Appellant and his then wife had a daughter in 1999. They decided to raise their daughter in rural Lymington. However, due to onerous work commitments, the Appellant lived in London during the week.

The Appellant and his wife were divorced in 2002. Following the divorce, the Appellant moved into Upper Pennington House in Lymington.

In June 2006, the Appellant purchased a flat in London (the Property) and in July 2006 he applied for and obtained a parking permit from the Royal Borough of Kensington & Chelsea – a requirement of which is that the applicant's main permanent home must be in the borough.

The Appellant's former wife remarried in June 2006 and discussed with the Appellant the possibility of her moving to Spain with their daughter. The Appellant was very much opposed to the idea of his daughter living in Spain with his former wife and her new husband. He was therefore faced with the possibility of either his daughter moving to Spain or moving back to Lymington to look after her. Accordingly, in September 2006, the Appellant moved into Upper Pennington House full-time and rented out the Property until its sale in November 2009.

On 1 April 2014, HMRC sent the Appellant a discovery assessment, pursuant to section 29 Taxes Management Act 1970 (TMA), for the year ended 5 April 2010, assessing capital gains tax of £38,970.36 in respect of the disposal by the Appellant of the Property.

The Appellant appealed the assessment to the FTT on the basis that the gain was not chargeable as it qualified for PPR and lettings relief under sections 222 and 223, TCGA[2].

The FTT's decision

The issue before the FTT was whether the Property had been the Appellant's private residence. The FTT accepted that the Appellant had lived at the Property from 5 August to 26 September 2006, when he had moved back to Lymington to look after his daughter. The FTT had to determine whether the "nature, quality, length and circumstances" of occupation made that occupation "residence" for the purposes of section 222 TCGA (*Goodwin v Curtis*[3]). The FTT commented that the need for permanence or continuity should not be overstated (*John and Sylvia Regan*[4]). In this case, there was clear evidence that the Appellant had intended to be based on a long term basis in London.

The FTT found that when the Appellant moved into the Property, he hoped to live there on a continuous basis but was aware that circumstances might arise that would require him to live full-time in Lymington. He was therefore in a similar position to the taxpayer in *David Morgan v HMRC*[5], a case where, whilst there was some expectation of continuity, there was a definite possibility that the occupation could be cut short.

1. [2015] UKFTT 478 (TC).
2. It was common ground that if PPR applied, lettings relief would also apply so that the gain would be fully relieved and that if PPR did not apply, lettings relief would also not be available.
3. [1998] STC 475.
4. [2012] UKFTT 569.
5. [2013] TC 02596.

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Based on the evidence before it and in considering the "nature, quality, length and circumstances" of the Appellant's occupation of the Property, the FTT concluded that the Appellant's occupation was sufficient to qualify as a residence for the purposes of PPR and accordingly no tax arose on the Appellant's disposal of the Property. The appeal was therefore allowed.

Comment

As in many cases relating to PPR claims, this case involved a change in the taxpayer's personal life which led to a change of plan and the taxpayer living at different properties. Although the decision is very much based on the specific circumstances surrounding the Appellant's occupation of the Property, it does provide helpful guidance to taxpayers who wish to make similar claims in circumstances where they have occupied the relevant property for a short period of time.

The decision can be read here.

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Special relief granted for excessive tax demand

In *Montshiwa v HMRC*[6], the FTT has allowed the taxpayer's appeal against HMRC's decision not to grant "special relief" under Schedule 1AB, TMA.

Background

Dr Montshiwa (the Appellant) was born in Botswana and came to the UK to train as a medical doctor. He submitted tax returns for the years 1996-97 to 2004-05, inclusive. On 8 May 2006, the Appellant returned to Botswana. Notices requiring him to submit his 2005-06 and 2006-07 returns were sent to his UK address on or around 6 April 2006 and 2007, respectively, although he did not receive either notice. Penalty notices for 2005-06 and 2006-07 were sent to the same address in 2008.

In or around November 2009, notices imposing surcharges in respect of the 2006-07 return were sent. Following this, determinations under section 28C TMA for the 2005-06 and 2006-07 returns, in the sum of £17,121, were sent to the Appellant on or around 22 September 2009.

The Appellant returned to the UK on 11 September 2011. On 29 September 2011, HMRC wrote to the Appellant indicating, incorrectly, that the time limit for displacing the 2006-07 determination by way of a self-assessment expired on 5 April 2011. It also said that "all penalties for 2006-07 had been cancelled".

On 10 October 2012, the Appellant wrote to HMRC confirming that he wished to appeal for a reduction in his tax bill. HMRC responded on 12 November 2012 indicating, amongst other things, that there was no right of appeal against the determinations and that the time for submitting a self-assessment tax return for 2005-06 and 2006-07, had passed.

On 14 February 2013, the Appellant's new agent wrote to HMRC enclosing a revised return for 2006-07, indicating that the tax due for 2006-07 was £325.71. A formal claim for special relief was submitted to HMRC on 1 October 2013.

On 3 February 2014, HMRC wrote to the Appellant giving notice of enquiry into the claim for relief.

6. [2015] UKFTT 0544 (TC).

On 1 May 2014, HMRC wrote to the Appellant informing him that it had concluded its enquiry and enclosing a closure notice. In the opinion of HMRC, the criteria for a claim for special relief had not been met and the Appellant's claim for special relief was rejected.

On 20 May 2014, the Appellant appealed against the decision in the closure notice. Following a review which upheld the original decision, the Appellant appealed to the FTT on 3 September 2014.

The Appellant relied on Condition A in paragraph 3A(4) of Schedule 1AB TMA, namely, whether it would be "unconscionable" for HMRC to seek to recover the amount of £17,121 it claimed was owed by the Appellant.

The FTT's decision

The FTT allowed the Appellant's appeal against HMRC's decision to deny special relief under Schedule 1AB and upheld HMRC's assessments for penalties.

This had the effect of reducing the Appellant's tax liability to £325.71 and the corresponding surcharge to 10% of that amount. Penalties remained in the sum of £200.

In reaching its decision, the FTT considered that HMRC had not taken into account the information provided by the Appellant's agent when the formal claim for special relief was submitted. The disparity between the estimated tax due of £17,121 was in absolute and relative terms substantially in excess of the actual liability of £325.71. As such, HMRC's decision that Condition A was not satisfied was unreasonable.

With regard to penalties, the FTT did not consider the Appellant to have a reasonable excuse for failing to submit his 2006-07 return. He had not done everything in his power to provide his agent with enough information to file a return and he was aware that his tax would be calculated under the self-assessment regime having filed returns for nine years previously.

Comment

The issue of special relief is often before the FTT. In this case, like the differently constituted FTT in *Scott v HMRC*[7], the FTT preferred *Currie v HMRC*[8], to *Maxwell v HMRC*[9]. Currie determined that the FTT could only decide whether HMRC's refusal to grant special relief was "Wednesbury" unreasonable, in the judicial review sense[10]. It could not substitute its own view on whether to grant relief. In Currie it was accepted that "unconscionable" meant "unreasonably excessive" or "completely unreasonable".

In the view of the FTT, once a taxpayer has identified that HMRC's determination is excessive, as in the instant case, HMRC must consider whether that excess is unreasonable. If the excess is large in absolute and relative terms, other factors would have to have considerable impact to displace that excess as the determining factor. In the present case, HMRC's failure to take this significant factor into account made denial of special relief unreasonable. This, together with HMRC's failure to consider the Appellant's representations, rendered the decision "so outrageous that no reasonable decision-maker could have reached it" and the FTT had little difficulty in allowing the Appellant's appeal.

7. [2015] UKFTT 0420 (TC).
8. [2014] UKFTT 882 (TC).
9. [2013] UKFTT 459 (TC).
10. *Associated Provincial Picture Houses Limited v Wednesbury Corporation* (1948) 1 KB 223.

Interestingly, the FTT also expressed the view that Parliament must have intended that HMRC would explain why, given a numerical disparity, it considered the excess reasonable (in the present case, HMRC had failed to do so). Taxpayers who find themselves in a similar position to the Appellant in this case, should request that HMRC set out in writing why it considers special relief is not available and why it considers its decision to be reasonable.

The decision can be read here.

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Upper Tribunal confirms "flip-flop II" scheme was effective

In *Clive Bowring and Juliet Bowring v HMRC*[11], the Upper Tribunal (UT) has allowed the taxpayers' appeal and concluded that a scheme, designed to reduce capital gains tax due on capital payments made by a trust, was effective.

Background

Clive Bowring and his sister Juliet Bowring (the Appellants), appealed to the UT against a decision of the FTT. The FTT had dismissed their appeals against closure notices which had amended their self-assessment tax returns for 2002-03, to the effect that they were liable to capital gains tax of £849,644 and £317,417, respectively, as a result of additional gains under section 87, TCGA and supplemental charges under section 91 TCGA. All statutory references below are to TCGA.

The Appellants had been beneficiaries of an offshore discretionary settlement created by their father in 1969 (the 1969 trust) which, by 2001-02, had trust gains (within the meaning of section 87(2)) of some £3 million. By virtue of section 87(4), these gains would be treated as chargeable gains accruing to the beneficiaries of the 1969 trust who received distributions from the trustees and would give rise to a capital gains tax charge at a total rate of 64%.

In 2002, Clifford Chance (Mr Bowring's solicitors) wrote to Mr Bowring commenting that it was likely that the trustee of the 1969 trust would make further distributions to the Appellants and suggested that planning known as "flip-flop mark II" be implemented before any such distributions were made.

In pursuance of this planning, another discretionary settlement was created in 2002, with the Appellants as beneficiaries (the 2002 trust). The assets of the 1969 trust were sold and the proceeds used to purchase £4 million worth of gilts. The trustee of the 1969 settlement borrowed £3.8 million on the security of the gilts, which was transferred to the 2002 trust. Subsequently, distributions of £2.4 million were made to the Appellants by the trustees of the 2002 trust. In May 2002, the trustee of the 1969 trust sold the gilts and repaid the loan.

The Appellants argued that the source of the distributions was the 2002 trust alone, which meant that section 90(5)(a) operated to prevent section 90(1) from applying to the transfer, so that no tax liability was incurred on the distributions. HMRC argued that the capital payments had been made by the 1969 trust via the 2002 trust acting as an intermediary, and therefore a transfer of settled property did not occur within the meaning of section 90(1).

The parties agreed before the FTT that for the purposes of section 97(5), the distributions could not be regarded as received from both sets of trustees, as this would give rise to multiple charges to capital gains tax which Parliament could not have intended.

11. [2015] UKUT 0550 (TCC).

The FTT, in dismissing the Appellants' appeals, held that section 97(5) should be interpreted widely, so that a capital payment could be regarded as received by a beneficiary from the trustees of one trust directly and from the trustees of another trust indirectly and that section 87(5) would prevent any multiple taxation which might otherwise arise.

The UT's decision

The question for determination by the UT was whether the capital payments received by the Appellants should be treated as if made from the 1969 trust rather than from the 2002 trust, for the purposes of section 97(5).

The Appellants argued that it was not possible to regard the capital payments as other than made by and received from the 2002 trust. HMRC argued that, taking a realistic view of the facts and applying the "signposts" referred to in *Herman v HMRC*[12], the capital payments had been made by the 1969 trust via the 2002 trust acting as intermediary. Accordingly, "transfer ... of ... settled property" to the 2002 trust did not occur within the meaning of section 90(1) and therefore there would have been no transfer of trust gains between the two settlements, even if section 90 had not been 'switched off' by section 90(5)(a).

In the view of the UT, the FTT had erred in holding that section 97(5)(a) permitted the same capital payment to be treated as having been "received ... from" the trustees of one settlement directly and from the trustees of another settlement indirectly. Section 87(5) had to be construed as operating in respect of receipts from a single settlement in a single year and could not provide a solution to the risk of double taxation which might arise if a single capital payment could be "received ... from" more than one trust. The absence of any means of avoiding the risk of multiple taxation, and other anomalies and uncertainties to which the FTT's construction of section 97(5)(a) would give rise, was a strong indication against the adoption of it. In addition, section 97(5)(a) was framed in terms which naturally appeared to envisage that a particular payment should be "received ... from" a single trust, either directly or indirectly. The natural meaning and effect of indirect receipt in section 97(5)(a) was that a beneficiary was still to be taken to have received a payment from a trust even if it was paid to him through an intermediary. It was conceivable that a separate trust could constitute such an intermediary, but the payment would not, in such circumstances, fall to be treated as "made by" and "received from" that intermediary.

HMRC's approach to section 90 ignored the clear words and intended effect of the legislation. Section 90 referred to a straightforward legal concept, namely, a transfer of settled property. Such a transfer took place if property ceased to be settled property of the transferor trust and became settled property of the transferee trust. Section 90 expressly acknowledged such a transfer by ensuring that relevant trust gains were also transferred, because it assumed it was from the trustees of the transferee trust that capital payments from the transferred property would be received. The UT said that no real exercise in interpretation or construction was required in order to ascertain whether such a transfer of settled property had occurred and in the instant case it clearly had. It was not possible to construe section 90 in such a way that the actual transfer was treated as not having occurred for tax purposes. Such a construction would reflect neither a realistic view of the facts or be consistent with the clear purpose of the legislation.

In the view of the UT, the trustee of the 1969 trust made an outright and unconditional transfer of its settled property to the 2002 trust. There was no agreement between the trustees of the two trusts, and the trustee of the 1969 trust had no say in what the trustees of the 2002 trust did with the transferred property. The UT concluded that it was not possible, taking a realistic

12. [2007] STC (SCD) 571.

view of the facts, to regard the 2002 trust as a mere intermediary in the sense that would be necessary if the distributions were to be treated as "received … from" the 1969 trust indirectly. The capital distributions were clearly "received … from" the 2002 trust and accordingly the appeal was allowed.

Comment

Although the arrangements had envisaged virtually all the transferred property being paid to the beneficiaries of the 2002 trust and the trustees of both trusts had knowingly implemented the scheme, this did not change the fact that the settled property in the 1969 trust had been transferred to the 2002 trust. Accordingly, when the 2002 trustees made the capital payments, they did so entirely in the exercise of their own discretion. Whilst HMRC no doubt considered the arrangements entered into as constituting unacceptable tax avoidance, the UT has confirmed that it is not always possible for HMRC to strain the facts in order to produce the outcome it desires. It would not be surprising if HMRC was to seek to pursue an appeal to the Court of Appeal.

The decision can be read here.

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RPC Christmas Appeal – Project Harmony: www.justgiving.com/ProjectHarmony

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RPC is a modern, progressive and commercially focused City law firm. We have 78 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

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