RPC

Tax update

February 2016

News

Increased SDLT for second homes and buy-to-let properties to apply to all

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Direct recovery of tax debts – new regulations and new guidance

Regulations which set out the information that deposit takers must provide to HMRC under the new Direct Recovery of Tax Debts Rules were made on 8 December 2015 and became law on 25 January 2016. more›

Revised DOTAS guidance published

HMRC has published revised DOTAS guidance. There is a single form AAG6 which replaces the multiple forms used in the past. more›

Cases

HMRC fails to satisfy the Tribunal that residential property purchased for a pension fund was "taxable property"

In *J & A Young (Leicester) Limited and Others v HMRC*[1], the First-tier Tribunal (FTT), allowed the taxpayers' appeals and held that certain residential property acquired by a self-administered occupational pension scheme was not "taxable property", for the purposes of Schedule 29A, Finance Act 2004 (FA 2004). more›

Tribunal allows company's appeal and confirms that the four-year time limit does not apply to corporation tax self-assessment returns

In *Bloomsbury Verlag GmbH v HMRC*[2], the FTT held that the four-year time limit does not apply to corporation tax self-assessment returns and that trading losses can be carried forward even though they were not included in a return. more›

UK source of interest

In *Ardmore Construction and Andrew Perrin v HMRC*[3], the Upper Tribunal (UT) dismissed the taxpayers' appeals and confirmed that they had received UK source dividends on which UK income tax was deductible at source. more›

Any comments or queries?

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News

Increased SDLT for second homes and buy-to-let properties to apply to all

The Financial Secretary to the Treasury, David Gauke, has provided an answer to a written question in the commons which confirms that the increase in SDLT to be charged in respect of second homes and buy-to-let properties, will extend to foreign investors and people not domiciled in the UK "in exactly the same way as UK residents".

Mr Gauke went on to say: "if purchasers own another property anywhere else in the world and are purchasing an additional property in England, Wales or Northern Ireland they will be charged under the new rates."

The Written Response can be read here.

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Direct recovery of tax debts – new regulations and new guidance

Regulations which set out the information that deposit takers must provide to HMRC under the new Direct Recovery of Tax Debts Rules were made on 8 December 2015 and became law on 25 January 2016.

The regulations can be read here.

HMRC has published draft regulations which refer to the circumstances in which banks and building societies may pass on administrative charges to customers.

The draft legislation can be read here.

HMRC has also published new guidance on the factors it will take into account when determining whether a taxpayer is at a disadvantage for the purposes of the direct recovery regime. This is intended to provide a safeguard for vulnerable debtors. The issues HMRC will consider include, disability or long-term ill health, temporary illness and mental health conditions. HMRC must also consider personal issues such as recent bereavement, job loss or circumstances of domestic abuse.

HMRC retains a great deal of discretion when exercising its direct recovery powers and it is to be hoped that it will exercise this new power reasonably and proportionately.

HMRC's guidance can be read here.

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Revised DOTAS guidance published

HMRC has published revised DOTAS guidance. There is a single form AAG6 which replaces the multiple forms used in the past.

The new AAG7 must be used by employers to report SRNs to employees.

The revised guidance can be read here.

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Cases

HMRC fails to satisfy the Tribunal that residential property purchased for a pension fund was "taxable property"

In *J & A Young (Leicester) Limited and Others v HMRC*[1], the First-tier Tribunal (FTT), allowed the taxpayers' appeals and held that certain residential property acquired by a self-administered occupational pension scheme was not "taxable property", for the purposes of Schedule 29A, Finance Act 2004 (FA 2004).

Background

J & A Young (Leicester) Limited (the Company) operated a plastic recycling and reprocessing business, one of the sites relating to which was located in Loughborough. The site comprised a factory building (the Factory) and a large adjoining yard (the Yard). The operations in the Yard comprised unloading used plastic materials from lorries, sifting the plastic, bailing and reloading the plastic which was then exported.

The J & A Young (Leicester) Limited Retirement Fund (the Fund) is a small self-administered occupational pension scheme registered with HMRC for the benefit of certain of the Company's employees. At all times relevant to the appeals, the Fund owned the Yard, but did not own the Factory. The Company acted as Scheme Administrator.

The Fund purchased a residential property (the Property) in Loughborough in October 2006. The Property is a three bedroom semi-detached house located about a mile away from the Factory and Yard in Loughborough.

The Property had been purchased to provide living accommodation for employees who were working in the Yard.

HMRC issued an assessment to the Company (as Scheme Administrator) to a scheme sanction charge, pursuant to sections 174A and 185A, FA 2004, and unauthorised payment charges were assessed on various members of the scheme under section 174A FA 2004.

The law

Paragraph 6, Schedule 29A, FA 2004, provides that "residential property" prima facie is "taxable property" for the purposes of an investment regulated pension scheme under FA 2004.

It was common ground that the Property constituted "residential property" within paragraph 7(1)(a), Schedule 29A, FA 2004, because the Property was used "as a dwelling". The issue between the parties was whether any of the exclusions contained in paragraph 10, Schedule 29A, FA 2004, applied, so that the Property would fall outside the definition of "taxable property".

Paragraph 10 provides, so far as relevant, as follows:

> *"(1) Residential property is not taxable property in relation to a pension scheme if Condition A or B is met.*
>
> *(2) Condition A is met if the property is (or, if unoccupied, is to be) occupied by an employee who ...*

1. [2015] UKFTT 0638 (TC) TC 04771.

c) is required as a condition of employment to occupy the property.

(3) Condition B is met if the property is (or, if unoccupied, is to be) …

(b) used in connection with business premises held as an investment of the pension scheme".

The FTT's decision
The issue before the FTT was whether the Property was "taxable property", for the purposes of Schedule 29A, FA 2004.

Condition A
The FTT accepted that the Property was occupied by the employees and also that in the material periods the Property was used only by employees who worked solely at the Yard. The only issue in dispute between the parties related to paragraph 10(2)(c) ie whether the employees were required as a condition of employment to occupy the Property.

Following a careful analysis of the relevant employment condition, the FTT concluded that there was no requirement that the employees should occupy the Property and therefore Condition A was not met.

Condition B
The FTT considered whether occupation by the employees of the Property meant the Property was "used in connection with" the Yard, for the purposes of paragraph 10(3)(b).

In the view of the FTT, two propositions could be derived from the many authorities which had considered the meaning of the phrase "in connection with" in different contexts. First, the words "in connection with" generally have a very broad meaning. Secondly, the degree of connection – the remoteness, proximity and type of connection required by the use of that phrase in a particular statute, must be identified from the particular statutory context in which it is used.

In the view of the FTT, the fact that the Property was acquired for the purpose of providing accommodation for employees working in the Yard and was used solely by such employees for that purpose (there was no element of personal use or benefit to members of the Fund or persons connected with them), was sufficient to establish the nexus that Condition B requires in order to be satisfied. The FTT therefore concluded that the use of the Property to provide accommodation for the employees working in the Yard was a sufficient connection for the purposes of paragraph 10(3)(b), and allowed the appeal.

Comment
The FTT has provided some helpful guidance on the approach to be taken when considering whether Conditions A or B are met. The FTT noted that there was no artificiality or manipulation involved in the arrangements, and this may have influenced the approach adopted by the FTT in arriving at its conclusion.

Given the FTT's findings of fact, there would appear to be little prospect of HMRC successfully appealing this decision, should it decide to appeal.

The decision can be read here.

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Tribunal allows company's appeal and confirms that the four-year time limit does not apply to corporation tax self-assessment returns

In *Bloomsbury Verlag GmbH v HMRC*[2], the FTT held that the four-year time limit does not apply to corporation tax self-assessment returns and that trading losses can be carried forward even though they were not included in a return.

Background

Bloomsbury Publishing Plc, a UK resident company acquired Bloomsbury Verlag GmbH (the Appellant), which was incorporated in Germany, in 2003. Though it was not clear to the Appellant at the time, following its acquisition, it became UK resident and was obliged to notify HMRC of its chargeability to corporation tax under paragraph 2, Schedule 18, Finance Act 1998 (FA 1998). The Appellant did not immediately appreciate its obligations to notify HMRC of its chargeability to corporation tax and this was not done until 31 March 2010.

In that notification the Appellant informed HMRC that it was in the process of preparing returns and computations for the accounting periods ending 31 December 2003 to 2009. The Appellant provided HMRC with a summary of the position for those years explaining that for 2003, 2004, 2006 and 2009, it had sustained trading losses but had made profits in 2005, 2007 and 2008. The majority of the losses were incurred during 2003 and 2004 and far exceeded the profits made in 2005, 2007 and 2008.

As required under paragraph 3, Schedule 18, FA 1998, HMRC issued notices requiring the Appellant to file returns for accounting periods 2004 to 2009, but not 2003. HMRC later attempted to withdraw its request for 2004 and 2005, indicating that these had been issued "in error". The Appellant submitted its returns for all years including a return for 2003 on what it described as a "voluntary" basis. HMRC rejected the returns the Appellant filed for 2003, 2004 and 2005 on the basis that they were late given the four year time limit contained in paragraph 46, Schedule 18, FA 1998. HMRC also disputed the availability of the 2003 and 2004 losses. It opened an enquiry into the 2007 return and issued a discovery assessment and a closure notice for the accounting periods ended 31 December 2005 and 2007, respectively, charging tax and penalties.

The Appellant appealed to the FTT.

The FTT's decision

During the hearing, HMRC indicated that it did, in fact, have a power to require a taxpayer to provide a return for any period. This ran contrary to the argument that the 2004 and 2005 notices had been issued in "error" as HMRC contended but HMRC's broader point was that this right could not be found to circumvent the time limitations on self-assessment contained in paragraph 46, Schedule 18, FA 1998. It was argued that whether HMRC could request a return or not, the taxpayer could not utilise its losses.

As a point of principle, the Appellant argued that it was not open to HMRC simply to deny the trading losses it had incurred in 2003 and 2004. The fact that they had not been included in a self-assessment return was irrelevant to the analysis of what constituted a loss in section 393, Income and Corporation Taxes Act 1988 (ICTA) (since rewritten to Corporation Tax Act 2010). HMRC rejected this analysis, arguing that losses had to be assessed in the same way as profits and that this could only be done through a valid return. Since, HMRC argued, the Appellant was out of time to file returns for 2003 and 2004, those losses did not "exist" to carry forward to later years.

2. [2015] UKFTT 660 (TC).

HMRC further contended that in raising the discovery assessment for 2005, it was not obliged to consider the losses which it accepted had been suffered in the preceding two years when determining whether there was any "loss of tax" to the Exchequer.

The FTT was not persuaded that taxpayers had any right under the statute to make a "voluntary" return as the Appellant had done for 2003. Rather, the legislation provided HMRC with a discretion to issue a notice to deliver a return. That discretion was not, however, to be exercised in an unfair or arbitrary manner. However, in relation to 2004, the FTT found that the return provided by the Appellant, in response to HMRC's notice to deliver, was valid. The FTT rejected HMRC's argument that the four year time limit contained in paragraph 46(1) applied to a self-assessment delivered in response to a notice. In its view, paragraph 46 applied only to an assessment made by HMRC.

In relation to 2004, the FTT said that there was no requirement for the Appellant to include an assessment in its return (as proscribed by paragraph 7, Schedule 18, FA 1998) because no amount of tax was due for this year. The FTT concluded, contrary to HMRC's submissions, that losses were not assessable since an assessment is only required for determining whether tax is payable, or whether a liability is nil. The assessment, per se, is not concerned with the computation of losses but rather the extent of any resultant tax liability. The Appellant was therefore able to use its 2004 losses to set against its profits in 2005 and 2007.

In relation to 2003, although the FTT said that the Appellant could not issue a "voluntary" return, it agreed with the Appellant's argument that it was entitled to utilise losses incurred in 2003 by operation of section 393, ICTA. Box 4 on the 2005 and 2007 returns indicated the level of the trading losses the Appellant had brought forward to offset against income. It did not matter that they were not included in a previous return. The fact that HMRC did not issue a notice requiring a return to be made for this period was irrelevant.

Comment
The remarkable aspect of this case is the length to which HMRC was prepared to go to ensure that the correct tax treatment was not available to the taxpayer.

The FTT was not impressed with HMRC's arguments which, had they succeeded, would have denied the Appellant a statutory relief to which it was entitled.

As counsel for the Appellant put it: "HMRC's attempt to restrict the use of the trading losses by reference to the provisions of Schedule 18 confused the procedure for assessing and collecting tax with the computational requirements of the Corporation Tax Acts. Schedule 18 was designed to operate on the basis that taxpayers should always pay the correct amount of tax properly computed."

HMRC would do well to remember that its function is to ensure the collection of the correct amount of tax rather than the maximum amount of tax. It remains to be seen whether HMRC will appeal this decision, or seek to change the law. We would not be surprised if HMRC went down the latter route.

The decision can be read here.

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UK source of interest

In *Ardmore Construction and Andrew Perrin v HMRC*[3], the Upper Tribunal (UT) dismissed the taxpayers' appeals and confirmed that they had received UK source dividends on which UK income tax was deductible at source.

Background

Ardmore Construction Ltd (Ardmore) and Andrew Perrin (Mr Perrin) (together the Appellants) each appealed against separate decisions of the FTT ([2014] UKFTT 453 (TC) and [2014] UKFTT 223 (TC)) that interest paid on loans arose in the UK and they were liable for tax that should have been deducted by the payer of the interest under section 874 Income Tax Act 2007 (ITA).

Mr Perrin was resident and domiciled in the UK. He was the managing director of a UK company which made contributions to a retirement benefits scheme via two trusts. One of the trusts made loans to Mr Perrin, payment of which was made from the trust's Isle of Man bank account to Mr Perrin's Isle of Man bank account. The underlying loan agreement was governed by Isle of Man law. Mr Perrin made two interest payments from funds in his Isle of Man account.

The FTT determined that Mr Perrin's obligations to pay would have been enforced or would have substantially originated from the UK. It found that the factors of Mr Perrin's residence in the UK and the source of funds for payment or enforcement in the UK outweighed that of the Isle of Man's jurisdiction and actual payments there, and therefore the interest payments arose in the UK for the purposes of section 874 ITA.

In the case of Ardmore, a UK company, two Gibraltar trusts lent funds to it pursuant to facility agreements. Ardmore also entered into loan agreements with companies registered in the British Virgin Islands which were owned by the trusts. Interest payments were made from Ardmore's bank account in the UK, funded by income from Ardmore's UK trading activities. In determining the source of the interest, the FTT referred to Ardmore's residence in the UK and found that the UK, as well as being the source or origin of the funds for payment, was the place of enforcement of the debt.

Relying on *National Bank of Greece SA v Westminster Bank Executor & Trustee Co (Channel Islands)*[4], the Appellants submitted that the source of the interest should properly be found by ascertaining the "nationality" or "residence" of the relevant loan instrument, or the place where the credit was provided, and the FTT had erred in applying a multi-factorial test.

Alternatively, if the multi-factorial test was the proper test, the FTT erred by affording too much weight to the Appellants' residence.

The UT's decision

The Appellants' appeals were dismissed by the UT.

The Appellants relied upon the following three principal grounds of appeal, each of which were in the alternative:

- the source of interest should be found by ascertaining the "nationality" of the loan instrument
- the residence of the debtor is not a material factor in determining situs (ie the multi-factorial test)
- the place where credit is provided is the source of the interest.

In the view of the UT, the interest arose in the UK.

3. [2015] UKUT 633.
4. [1971] AC 945.

The UT gave weight to the residence of the payer and the source of the funds that the payer used to make the payments. Ardmore was repaying its loan using money derived from UK trading activities and Mr Perrin was not able to demonstrate that he could repay his loan from non-UK sources.

The place where the loan was provided and the residence of the lender were not relevant. The UT agreed with HMRC that the question of whether the interest had a UK source was not the same as whether the loan had a UK legal situs.

The UT considered that the FTT was right to have placed such significance on the residence of the debtor and the source of the payments. The *National Bank of Greece* case applied so that the source of the obligation to pay interest was pertinent and had to be determined by reference to all the relevant factors. The UT said that it was not possible to list an exhaustive set of relevant factors, since this would depend on the facts of each case. However, the residence of the debtor was material.

The UT therefore concluded that a multi-factorial test applied to determine whether interest arose in the UK for the purposes of UK withholding tax on interest. The UT's decision accords with HMRC's Savings and Investments Manual guidance that a number of factors must be considered, with the residence of the debtor being material. It is pertinent that section 874(6A) ITA now expressly provides that, with effect on and from 17 July 2013, the legal situs of a debt is irrelevant in determining whether interest arises in the UK.

Comment
This case is a reminder that it is important to determine whether payments of interest are from a "UK source" or "arise in the UK", as such interest is subject to withholding tax unless specific exemptions apply, or the withholding obligation can be removed by a double tax treaty or the EU Interest & Royalties Directive.

It is also of relevance to individuals who are resident, but not domiciled in the UK, who seek to rely on the remittance basis of taxation in respect of non-UK source income and gains.

In practice, considerable reliance is placed on HMRC's published guidance (SAIM9090) which states that whether or not interest has a UK source depends on all the facts and on how the transactions are carried out. Some relevant factors include:

- the residence of the debtor and the location of his assets
- the place of performance of the contract and the method of payment
- the competent jurisdiction for legal action and the proper law of contract and
- the residence of any guarantor and the location of any security for the debt.

In light of the above, it will be difficult to avoid the conclusion that interest paid by a UK resident has a UK source if that interest, or the repayments of principal, are made (or will very likely be made) out of UK income and assets.

The decision can be read here.

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About RPC

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