McKie&Co

TAX PLANNING BULLETIN

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Introduction

For most people the last echoes of 'Happy New Year' have faded away and they are enjoying, if that is the correct word, their January abstinence. Tax advisers, however, operate under the old ecclesiastical year and the pleasures of self assessment returns in January are succeeded by the excitements of the Budget and the bacchanalian excesses of the evening of 5th April before the tax year comes to an end.

Meanwhile Her Majesty's Revenue & Customs continue to add to the gaiety of the Nation.

At the time of the Pre-Budget Report they issued draft legislation on Capital Losses which will affect a host of ordinary tax planning in relation to investments and a commentary on it which denied that this was the case. They have continued to persecute country folk, persuading the Special Commissioners in *Arnander Lloyd & Villiers* to take a narrowly restrictive view of what is a farmhouse. In *Gaines-Cooper,* they argued for an interpretation of the residence legislation which contradicted their own published guidance and they have continued to pursue the Jones family appealing to the House of Lords having lost in the Court of Appeal in *Jones v Garnett*.

With so much fun and excitement on offer, does one need any more? It is there in the prospect of Mr Brown's last Budget and the appointment of the first new Chancellor for a decade.

Our cup runneth over.

Sharon McKie **Simon McKie**

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A. CAPITAL GAINS TAX

1. Capital Losses: Anti-avoidance Rule Announced by Pre-Budget Report

Context

A targeted anti-avoidance rule (TAAR) is to be introduced to counter schemes that create and use artificial capital losses to avoid tax. HMRC state that the measure will restrict allowable capital losses to those arising from genuine commercial transactions. However, the loss restriction will in fact apply to many genuine commercial transactions.

The changes will take effect in relation to capital losses arising on disposals on or after 6th December 2006.

Current law and proposed revisions

TCGA 1992 s.16 provides that, unless there is an express rule to the contrary, a capital loss is computed in the same way as a capital gain, and a loss will be an ‘allowable loss’ if a gain arising on the same transaction would have been a chargeable gain.

An express exception to this general rule was introduced by FA 2006. TCGA 1992 s.8 states that loss accruing to a company is not an allowable loss if it arises as part of arrangements which have a tax advantage as their main purpose, or one of the main purposes. The intention of this provision being to deter the creation and use of artificial capital losses by companies liable to corporation tax on their chargeable gains.

The TAAR extends the anti-avoidance rule for companies to other persons liable to CGT namely individuals, trustees and personal representatives. Where a person has made arrangements, and the main purpose of which is to gain a tax advantage by creating an artificial capital loss, any resulting loss will not be an allowable loss for the purposes of CGT, income tax or corporation tax.

The measure will introduce, in a new s16A, a general rule covering capital gains tax, income tax and corporation tax, and hence replacing the corporation tax provisions introduced into TCGA 1992 s8 by FA 2006, without changing their effect.

(HMRC PBRN 18 6.12.06)

Comment

For those who have been involved in such loss schemes, the wonder perhaps is not so much that the announcement was made, but that it took so long to appear.

B. INHERITANCE TAX

2. Agricultural Property Relief: Was This House a Farmhouse Qualifying for Relief?

Context

The latest farmhouse case to come before the Special Commissioner, in this case Dr Nuala Brice, had what might be generously described as ‘unpromising facts’. Not surprisingly Dr Brice thought that the house in this case was not even a farmhouse. Although it was not required for the purposes of the decision she did consider the ‘character appropriateness’ test. We trust that this case will not be appealed, leaving the way open for a more sensible case to find its way to the High Court or above for judicial pronouncement to be applied on the relevant test.

Arnander, Lloyd and Villiers (executors of McKenna and another, deceased) v HMRC: the facts

Mr and Mrs McKenna owned a country estate in Cornwall consisting of their residence, the main house with six acres of gardens and domestic outbuildings (‘the house’), and 187 acres of land, most of which was farmland. The house, which was of medieval origin, had became disassociated from the farming activities on the estate in 1908 when a new farmhouse was built and let, with the farmland and farm outbuildings, to tenant farmers. In 1984 the tenant farmer surrendered his tenancy and Mr and Mrs McKenna decided to enter into contract farming arrangements for arable farming. They employed a land agent who was responsible for the management of the land, the farming activities, the invoicing of the contractors and all discussions with the contractors. The agent had approximately five meetings a year with Mr McKenna, sometimes informally, to discuss farm matters either by telephone or in the house. Mr McKenna personally prepared and kept meticulous documents and records of the arrangements and paid income tax under Schedule D. In 2003, after a prolonged period of ill health, Mr and Mrs McKenna died within five months of each other. In 2004 the estate was sold, as a residential property, for £3,050,000.

The three executors of Mr and Mrs McKenna’s estate (‘the appellants’) sought to obtain agricultural property relief from IHT in respect of the house. Although HMRC allowed relief in respect of 110 acres of land and one farm outbuilding, they issued notices of determination denying relief on the house on the grounds that it was not an interest in agricultural property within the meaning of IHTA 1984 s115(2).

The appellants appealed and the following issues arose for consideration:-

(1) Whether the house (with its gardens and domestic outbuildings) was a farmhouse within the meaning of s115(2). The appellants contended that the house was the dwelling of the owners of the farm and the place from which the farming business was managed. They were in charge of the direction of the farming business; they directed the contractors through their agent; they maintained the business and tax records at the house and also had meetings with their agent to discuss farm policy there. HMRC argued that a farmhouse was a building with a particular function and in each case it was necessary to look at the function of the house performed in relation to the agricultural land.

(2) The occupant of the farmhouse had to be someone who could be called a farmer and who lived in the house in order to farm the land on a day-to-day basis.

(3) If the house was a farmhouse, whether it was, as the appellants argued, 'of a character appropriate to the property' within the meaning of s115(2).

(4) If so, whether the house was occupied for the purposes of agriculture throughout the period of two years ending with the relevant dates of death within the meaning of s117(a). The appellants contended that Mr and Mrs McKenna had been in occupation of the farmland for the purposes of agriculture and of the house as a farmhouse for the purposes of agriculture. The fact that the contractors undertook the day-to-day farming activities was a sensible feature of their farm operation given their age and strength. HMRC argued that, as the house was not a farmhouse of a character appropriate to the property, the issue did not arise.

(5) Whether the farm outbuildings were occupied for the purposes of agriculture throughout the period of two years ending with the relevant dates of death within the meaning of s117(a). The appellants submitted that all the farm outbuildings were used or kept ready for use predominantly for the purposes of the storage of farm machinery and utilities and were not used for any non-agricultural purposes.

The decision: SpC (Dr Nuala Brice)

The house (with its gardens and domestic outbuildings) was not a farmhouse within the meaning of IHTA 1984 s115(2).

In determining the correct interpretation of the word 'farmhouse' for the purposes of IHTA 1984 s115, Dr Brice began by deriving the following legal principles from the authorities. **A farmhouse was a dwelling for the farmer from which the farm was managed; the farmer of the land was the person who farmed it on a day-to-day basis rather than the person who was in overall control of the agricultural business conducted on the land; the status of the occupier of the premises was not the test, but the proper criterion was the purpose of the occupation of the premises.** However, if the premises were extravagantly large for the purpose for which they were used, or if they had been constructed upon some more elaborate and expensive scale, it might be that, notwithstanding the purpose of occupation, they should be treated as having been converted into something much more grand; and the decision as to whether a building was a farmhouse was a matter of fact to be decided on the circumstances of each case and was to be judged in accordance with ordinary ideas of what was appropriate in size, content and layout, taken in conjunction with the farm buildings and the particular area of farm being farmed.

Dr Brice then considered the factual context in the present case. Between 1908 and 1984 the house, as the appellants accepted, was not a farmhouse and in 1984 the tenant farmer surrendered his tenancy. From that date, day-to-day farming activities were conducted by contract farmers who were managed by the agent; Mr McKenna had discussions with the agent at the house which was also used to prepare and keep the farm accounts and other farm records; he received the payments from the contract farmers through the agent's firm and paid income tax under Schedule D Case 1 on the profits. **Applying the law to the facts, Dr Brice found that the house was not the main dwelling from which the agricultural operations over the land were conducted and managed.** The day-to-day management and all acts of farm husbandry over the land were solely the responsibility of the contractors who were managed by the agent. The engagement of an agent to manage the land meant that the use of the house for farming matters was very much reduced.

If the farmer of the land was the person who farmed it on a day-to-day basis rather than the person who was in overall control of the agricultural business conducted on the land, it followed that Mr McKenna was not the farmer. The purpose of his occupation of the house was not to undertake the day-to-day farming activities. In any event, the house was larger, grander, more elaborate and more expensive than was required for the reduced farming purposes for which it was in fact used. Its size, content and layout, taken in conjunction with the farm buildings and the particular area of farm being farmed, pointed to the conclusion that it was primarily a rich man's residence rather than a farmhouse. It followed that the house (with its gardens and domestic outbuildings) was not a farmhouse within the meaning of IHTA 1984 s115(2).

Although it was not therefore necessary to consider issues (2) and (3), Dr Brice went on to express her views. In relation to issue (2), **it was not appropriate to compile an exclusive list of relevant factors to consider when deciding whether a farmhouse was of a character appropriate to the agricultural land for the purposes of s115(2). The question was one of fact and degree and any factor could be relevant. The relevant factors in the current appeal were: the historical associations; the size, content and layout of the house; the farm outbuildings; the area being farmed and whether the house was proportionate to the land being farmed; the view of the educated rural layman; and the relationship between the value of the house and the profitability of the land.**

Dr Brice concluded that the house was not used as a farmhouse between 1908 and 1984 and thereafter its use for farming activities was very much reduced because of the use of an agent and the contract farming arrangements. The house was at the very top end of the size of farmhouses in Cornwall and farms with a house that size had more agricultural land. The house was sold as a large country house with farmland and not as a farm with a house. The value of the house was well out of proportion to the profitability of the farm. Accordingly, if the house was a farmhouse, then it was not 'of a character appropriate to the property' within the meaning of s115(2).

In light of her conclusions on issues (1) and (2), Dr Brice determined that the house (with its gardens and domestic outbuildings) was not occupied for the purposes of agriculture throughout the period of two years ending with the relevant dates of death within the meaning of s117(a). Even if the house had been found to be a farmhouse of a character appropriate to the property, it was clear that Mr and Mrs McKenna were not able to engage in farming matters throughout the period of two years ending with the relevant dates of death.

Lastly, on issue (4), after reviewing the evidence, Dr Brice found that three of the farm outbuildings were occupied for the purposes of agriculture between 1991 and 1993 within the meaning of s117(a), and eight outbuildings were not.

The appeals on the main issues were dismissed.

(Arnander, Lloyd and Villiers (executors of McKenna and another, deceased) v HMRC SpC 565 23.10.06 reported at [2006] STI Issue 45)

Comment

As we understand it, this case is not going to appeal, which must be a good thing. Indeed, it is unfortunate that it was ever taken by the Executors to the Special Commissioner in the first place. The facts might be described, at best, as 'unhelpful'. Although only at Special Commissioner level, the pity is that Dr Nuala Brice seems to have taken the opportunity to tighten somewhat her views on the application of the 'character appropriate test' and, more significantly, to reiterate the Lands Tribunal dictum in para 49 of their ruling in Antrobus No 2 *(see our Bulletin 15 Winter 2005/2006 Item 6), to the effect that the farmhouse is the residence of the person who farms the land on a day-to-day basis and not that of the person who is in overall control of the agricultural business conducted on the land.*

The hope is that, pending some sensible guidance from at least the High Court on the meaning of 'farmhouse' for APR purposes, we shall get an agreed statement of principles as between the CLA and HMRC before too long.

3. The FA 2006 Regime for Trusts: HMRC's Answers to the 43 Questions from STEP/CIOT

Following the introduction of the FA 2006 Regime for Trusts STEP/CIOT have entered into a dialogue with HMRC. HMRC have produced a revised response to a variety of Questions submitted by STEP/CIOT. Very few of the Questions have not been answered and it is interesting that in some 75% of cases HMRC agree with the analysis by STEP/CIOT, which is comforting. These Q&As contain a range of interesting points but are too numerous to reproduce in this Bulletin. There is, however, one Question and Answer which is of particular concern. Question 33 relates to a bare trust for a minor.

> "***Question 33***
>
> Can HMRC confirm that the application of s31 of the Trustee Act 1925 to assets held on a bare trust for a minor will not result in the assets being settled property within the meaning of IHTA 1984 s43?
>
> ***HMRC Answer***
>
> *We are seeking advice from our solicitors on this point.*
>
> There appear to be new and unforeseen CGT problems now where *Crowe v Appleby* [1975] STC 502 applies to settled property. The position is complex albeit common and can best be illustrated by example.
>
> ***Example 9***
>
> In February 2006 Andrew set up a trust for his children Charlotte and Luke. They each become entitled to one half of the income and capital on reaching 25. Charlotte becomes 25 in 2007 and Luke becomes 25 in 2009. They do not take interests in possession before reaching 25. The trust only holds one piece of land.
>
> When Charlotte reaches 25 in 2007 she becomes absolutely entitled for IHT purposes since *Crowe v Appleby* has no application for IHT purposes. The trusts over her share end for IHT purposes before April 6 2008 so there is no exit charge since she is within the transitional regime. She is treated from 2007 as entitled to the half share in the property and if she died after that date it would form part of her estate for IHT purposes and hence be potentially taxable.
>
> There is a further problem. For CGT purposes Charlotte does not become absolutely entitled to one half of the land. Until the land is sold or Luke reaches 25

and becomes absolutely entitled (whichever is the earlier) there is no disposal made by the trustees.

There is no IHT charge on 6 April 2008 but from that date Luke's share is no longer within A&M trust protection but is taxed as an 18-25 trust. There is no ten year anniversary charge before Luke reaches 25 but if he dies before then there is an IHT charge (likely to be less than 4.2%). As noted above, there is no base cost uplift for CGT purposes.

On Luke reaching 25 in 2009 there is an exit charge on Luke's share of 4.2%.

HMRC Answer

(Note: we do not consider this is quite right. We assume that the 4.2% is referred to on the basis of 7/10ths x 6%. However, the charge will not be based on the 7 years from Luke's 18th birthday. S.71F(5)(a) provides that the starting date for calculating the relevant fraction is his 18th birthday 'or, if later, the day on which the property became property to which section 71D above applies' - in this case, 6 April 2008).

If the land has not yet been sold there will at that point be a disposal of all the land by the trustees for CGT purposes because both beneficiaries become absolutely entitled. Hold-over relief is available on Luke's part under s260 TCGA 1992 but not on Charlotte's part since there is no exit charge. In summary, the trustees will have to pay CGT on any gain on Charlotte's share in 2009 and cannot hold over the gain on that share."

Comment

While HMRC have finally to pronounce on this issue, at least three insurance companies have, within the last week or two, issued warning statements to professional advisers and indeed a cautionary paragraph has been added onto the version of the Questions and Answers posted on the CIOT website:

"Practitioners should note that HMRC are considering whether any property held for a minor can be held on a bare trust or whether all property held for minors must necessarily constitute settled property EVEN IF s31 is excluded. Separate representations and discussions are taking place on this between CIOT/STEP and HMRC but, until further clarification is obtained, clients should consider the position carefully when transferring any assets to minor children unless they are certain that they wish such assets to be settled property with all the inheritance tax consequences this will involve."

Note that HMRC might confirm their view (apparently on the basis that the trustees have 'active duties') that such property is held on substantive trusts for IHT purposes even where the Trustee Act 1925 s31 has been excluded. If they were to persist in this view, which would be vigorously challenged by the professional bodies, could there also be an impact for CGT purposes, albeit that the definition of 'settled property' there is of course different from the definition of 'settlement' for IHT?

4. Capital Taxes Change of Name

As Capital Taxes no longer exists as an entity, HMRC have stopped using the name and the Department will in future be known as 'HMRC Inheritance Tax'. Over time, all references to Capital Taxes, CT and CTO will be removed from HMRC's letters, forms and guidance.

(HMRC's IHT Newsletter December 2006)

Comment

A sensible change – but we wonder how long hence the expression 'CTO' will still find itself in use!

C. STAMP DUTY LAND TAX

5. SDLT: Anti-avoidance Measures Announced by Pre-Budget Report

Context

On 6th December 2006 the Stamp Duty Land Tax (Variation of the Finance Act 2003) Regulations 2006 were introduced making ineffective a number of schemes designed to avoid SDLT, as announced in the Pre-Budget Report.

The measure has effect for transactions made on and after 2.00pm on 6th December 2006. There are transitional provisions to protect those who entered into contractual commitments before 2pm on 6.12.06. The Regulations counter avoidance of SDLT by changing the legislation in two respects.

The new s.75A

The first change provides that:-

- where one person disposes of a chargeable interest and another person acquires that interest, or one derived from it;

- a number of transactions (the 'scheme transactions') are involved in the disposal and acquisition; and

- the SDLT chargeable on all the scheme transactions is less than that which would have been chargeable on a single land transaction, the chargeable consideration for which is the total consideration given or received,

then the scheme transactions are disregarded and there is a notional land transaction, the chargeable consideration for which is the total consideration given or received.

The effective date of the notional land transaction is the last date of completion of the scheme transactions or, if earlier, the last date on which a contract in respect of the scheme transactions is substantially performed.

The examples of schemes given by HMRC to which the Regulations might apply are:

- The grant of a lease which gives the landlord the right to terminate the lease within a set period. The period expires without the landlord exercising the right and in return the tenant pays the landlord a sum of money.

- A agrees to sell property to B Ltd, a company. On completion B Ltd transfers the property to its parent, C Ltd, by way of a dividend *in specie*.

- V grants a lease for 999 years at a peppercorn rent to an unconnected nominee N. V assigns the freehold reversion to P. P pays N a sum of money in consideration of an agreement by N to vary the lease by inserting a provision giving P the right to terminate the lease.

Partnerships

The second change makes a number of amendments to FA 2003 Sch 15 dealing with transfers into and out of partnerships, and transfers of partnership interests. The changes are as follows:-

- When calculating the 'sum of the lower proportions' for the purposes of Sch 15 paras 10, 11, 18 or 19 partners which are connected with 'relevant owners' but which are not individuals are not treated as 'corresponding partners' in relation to that relevant owner.

- However, on a transfer into a partnership which is subject to Sch 15 para 10, relief similar to group relief can be claimed, so that the tax payable is reduced to what it would have been if companies which were members of the same group as a relevant owner were treated as corresponding partners in relation to that relevant owner. There are claw back provisions similar to those applying to group relief.

- Where there is a transfer of a partnership interest and the transferee is connected with the transferor but is not an individual, then there is a charge under Sch 15 para 14 regardless of whether consideration is given.

- The application of the group relief provisions to transfers of partnership interests is clarified to put it beyond doubt that group relief claimed on such a transfer is subject to the claw-back provisions in Sch 7 para 3.

The Regulations are made under powers contained in FA 2003 s109. The Regulations have immediate effect, but cease to do so unless approved by the House of Commons within 28 days.

Regulations to be replaced by FB 2007

As the Regulations have effect only for a period of 18 months they will be replaced by legislation in FB 2007. The Government have invited representations on the Regulations.

(HMRC press release PBRN 17 6.12.06)

Comment

In the context of uncertainty about the possible scope of the new s75A, it is hoped that HMRC Stamp Taxes might produce a 'white list' of transactions which are not caught.

D. MISCELLANEOUS

6. *Jones v Garnett*: Statement by HMRC

Context

The House of Lords will hear HMRC's appeal against the decision of the Court of Appeal in the case of *Jones v Garnett* (Arctic Systems Ltd) from 5 to 7 June 2007.

The *Jones v Garnett* case concerns arrangements involving a company called Arctic Systems Ltd. and relates to the Settlements legislation. HMRC have won before the Special Commissioners and the High Court. However, they lost in the Court of Appeal.

HMRC's guidance to taxpayers

HMRC state that:-

> "The Court of Appeal judgment represents the law as it now stands. It follows therefore that taxpayers whose circumstances are consistent with the situation in *Jones v Garnett* are entitled to self assess - or, within the time limits allowed, amend a self assessment - in accordance with that judgment. Clearly, each individual case is different and it is not easy to lay down a clear line which defines whether a case is consistent with *Jones v Garnett*. Because of that taxpayers will need to be guided by their advisers. If providing details using the 'white space' in a return is considered appropriate it would be helpful if the entry could be made at box 7.32 on the 'Trusts etc' pages of the individual SA return.
>
> Where there are open enquiries into similar cases HMRC's intention is to keep them open pending finality. A taxpayer who considers that he or she is affected by this judgment may, of course, apply to the Commissioners for a direction requiring HMRC to issue a closure notice. In those circumstances it is HMRC's intention to oppose the application on the grounds that the appeal to the House of Lords constitutes reasonable grounds for not issuing a closure notice."

(HMRC press release 24.11.06)

Comment

It is a pity that the issue has not been resolved by the 31 January 2007 date for filing 2005/06 returns – where the position will be very much as it was for 2004/05. Meanwhile, who is prepared to hazard a guess as to the outcome in the HL?

7. Domicile, Residence and Ordinary Residence: Mr Gaines-Cooper Loses his Case and HMRC Respond

Context

The issues in this case were: whether the taxpayer Mr Gaines-Cooper was domiciled in England during the tax years from 1992/93 to 2003/04; whether he was resident in the UK from 1993/94 to 2003/04; and whether he was ordinarily resident in the UK from 1992/93 to 2003/04.

Gaines-Cooper v HMRC: the facts

Mr Gaines-Cooper appealed against a number of assessments, amendments to self-assessments and notices which related to the tax years 1992/93 to 2003/04 concerning his liability for income tax under Sch D, Case VI either under TA 1988 s739-746 (relating to the transfer of assets abroad) and/or TA 1988 s660A-660G (relating to settlements and the liability of the settlor).

It was agreed between the parties that the issues of domicile, residence and ordinary residence of Mr Gaines-Cooper should be heard as preliminary issues. It was Mr Gaines-Cooper's case that he abandoned his domicile of origin in England and acquired a domicile of choice in the Seychelles in 1976 and that he had retained that domicile of choice ever since. He argued that there had been no home in the UK available for his use when it had been rented out and relied upon the facts that he had built a plastics factory in the Seychelles and had notified the Revenue and the Bank of England that he was non-resident in the UK. Further in the early years he had spent several months in the Seychelles each year compared to the number of days he spent in England.

It was HMRC's case that Mr Gaines-Cooper had never abandoned his domicile of origin. He had bought a house in the Seychelles and built a plastics factory there in order to obtain a residency permit, but the quality of his long established ties with the UK, his continued residence in the UK, together with his regular visits to the UK all established that he remained domiciled in the UK.

The decision: SpC (Dr Nuala Brice and Charles Hellier)

The Special Commissioners decided, as a preliminary issue, that Mr Gaines-Cooper had failed to establish on the balance of probabilities that he had abandoned his domicile of origin in England and acquired a domicile of choice in the Seychelles. Moreover, on the evidence, he had been resident and ordinarily resident in the UK during the relevant tax years.

The burden of proof was on Mr Gaines-Cooper.

Domicile

A domicile of choice was acquired by the combination of residence and the intention of permanent or indefinite residence and in reaching a decision it was necessary to look at the totality of the evidence, including events which occurred after the claimed acquisition of a domicile of choice. Residence for the purposes of the law of domicile meant physical presence as an inhabitant but where a person resided in two countries it was necessary to look at all the facts in the light of the principle that a person who retained a residence in his domicile of origin could acquire a domicile of choice in a new country only if the residence established in that new country was his chief residence. There must also be the intention of permanent and indefinite residence: a determination to make the alleged domicile of choice his home with the intention of establishing himself and his family there and ending his days in that country.

Viewed objectively, the facts and evidence in the present case did not support the conclusion that the Seychelles was Mr Gaines-Cooper's chief residence. England remained the centre of gravity of his life and his interests and his chief residence was there. There was no evidence of an intention of permanent and indefinite residence in the Seychelles nor any determination to make the alleged domicile of choice his home with the intention of establishing himself and his family there and ending his days in that country. Accordingly, Mr Gaines-Cooper had not discharged the burden of proving that he abandoned his domicile of origin in England.

Residence

As regards Mr Gaines-Cooper's residence, the concept of 'residence' was not defined in the legislation and the word had to be given its natural and ordinary meaning. The words 'residence' and 'to reside' meant 'to dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place' and whether a person was or was not resident in the UK was a question of fact for the Special Commissioners. Further, no duration was prescribed by statute and it was necessary to take into account all the facts of the case; the duration of an individual's presence in the UK and the regularity and frequency of visits were facts to be taken into account; also, birth, family and business ties, the nature of visits and the connections with this country, might all be relevant. In general the availability of living accommodation in the UK was a factor to be borne in mind in deciding if a person was resident (although that was now subject to TA 1988 s336(3)). The fact that an individual had a home elsewhere was of no consequence; a person might reside in two places but if one of those places was the UK, he was chargeable to tax there.

Although Mr Gaines-Cooper considered himself resident in the Seychelles, in all the circumstances he resided in both the UK and the Seychelles and so under general principles he was resident in the UK.

Temporary purpose

The words 'temporary purpose' in TA 1988 s336(1) had to be given their natural meaning and meant a casual purpose as distinguished from the case of a person who was in the UK in pursuance of his regular habits of life. On the facts of the present appeal, Mr Gaines-Cooper's purpose in visiting the UK was not a purpose which lasted for a limited time. It was a permanent and not a transient purpose nor was it simply a passing need. Neither was it a casual purpose but rather it was in pursuance of the regular habits of Mr Gaines-Cooper's life. A decision to visit the UK on a large number of days each year to be with his wife and child was not a temporary purpose. There was no general proposition that because a visit was short it must necessarily be for a temporary purpose. In all the circumstances, the presence of Mr Gaines-Cooper in the UK for the years under appeal was not for a temporary purpose.

[Specifically, note that the Special Commissioners did not accept Mr Gaines-Cooper's computations of days spent in the UK, viz ignoring days of arrival and departure as found in IR20. Rather, they agreed with HMRC's interpretation of the law that arrival on a Saturday and departure on the Sunday should count as one day spent in the UK. On this basis the rewritten schedule of days spent in the UK took Mr Gaines-Cooper rather over the 90 day limit in each of the tax years in question.]

The second cumulative requirement in s336(1)(a) was the absence of an intention on the part of Mr Gaines-Cooper to establish his residence in the UK. The fact that Mr Gaines-Cooper had a place to live in the UK was now to be ignored by virtue of s336(3). The evidence indicated that Mr Gaines-Cooper had no subjective intention of establishing his residence in the UK for the purposes of the Taxes Acts and would have done quite a lot to ensure that residence with that meaning was not established but that did not mean that objectively he was not resident. However since the requirements of a temporary purpose and no intention to establish residence were cumulative and not alternative, and as Mr Gaines-Cooper had been found not to be in the UK for a temporary purpose, the exemption in s336(3) did not apply.

Ordinary residence

Finally, the concept of 'ordinary residence' connoted residence in a place with some degree of continuity and 'ordinary' meant normal and part of everyday life, In the present case, Mr Gaines-Cooper was resident in the UK in the years of assessment under appeal and his residence was continuous in the sense that it continued from year to year. It was ordinary and part of his everyday life bearing in mind that his everyday life was far from ordinary. Moreover Mr Gaines-Cooper would still be ordinarily resident in the UK even if there were an occasional year when he was not so resident.

(Gaines-Cooper v HMRC SpC 568 23.10.06 reported at CCH Weekly Tax News Issue 429 27.11.06)

Comment

Following the decision of the Special Commissioners which has found its way into the Sunday broadsheets, HMRC have issued a response to the decision which is set out below.

HMRC Statement

HMRC Brief 01/07
Residence: Gaines-Cooper

> “The recently published decision of the Special Commissioners in Robert Gaines-Cooper v HMRC (SpC 568) has attracted some attention from tax practitioners and their clients. In particular, some commentators have suggested that the decision in Gaines-Cooper means that HMRC has changed the basis on which it calculates the ‘91-day test’. This is incorrect.
>
> The ‘91-day test’ is set out in Chapters 2 & 3 (‘Leaving the UK’ and ‘Coming to the UK – Short term visitors’) of the booklet IR20: Residents and non-residents. This guidance is clear that the ‘91-day test’ applies only to individuals who have either left the UK and live elsewhere or who visit the UK on a regular basis. Where an individual has lived in the UK, the question of whether he has left the UK has to be decided first. Individuals who have left the UK will continue to be regarded as UK-resident if their visits to the UK average 91 days or more a tax year, taken over a maximum of up to 4 tax years. HMRC’s normal practice, as set out in booklet IR20, is to disregard days of arrival and departure in calculating days under the ’91-day test’.
>
> In considering the issues of residence, ordinary residence and domicile in the Gaines-Cooper case, the Commissioners needed to build up a full picture of Mr Gaines-Cooper’s life. A very important element of the picture was the pattern of his presence in the UK compared to the pattern of his presence overseas. The Commissioners decided that, in looking at these patterns, it would be misleading to wholly disregard days of arrival and departure. They used Mr Gaines-Cooper’s patterns of presence in the UK as part of the evidence of his lifestyle and habits during the years in question. Based on this, and a wide range of other evidence, the Commissioners found that he had been continuously resident in the UK. From HMRC’s perspective, therefore, the ’91-day test’ was not relevant to the Gaines-Cooper case since Mr Gaines-Cooper did not leave the UK.

HMRC can confirm that there has been no change to its practice in relation to residence and the ‘91-day test’. HMRC will continue to:-

- follow its published guidance on residence issues, and apply this guidance fairly and consistently;
- treat an individual who has not left the UK as remaining resident here;
- consider all the relevant evidence, including the pattern of presence in the UK and elsewhere, in deciding whether or not an individual has left the UK;
- apply the ‘91-day test’ (where HMRC is satisfied that an individual has actually left the UK) as outlined in booklet IR20, normally disregarding days of arrival and departure in calculating days under this ‘test’.

The guidance provided by booklet IR20 is general in nature. If, on the facts of the matter, a dispute arises over the application of this general guidance and the parties cannot resolve their dispute by agreement, the Commissioners will determine any appeals. The Commissioners are bound to decide the legal issues by reference to statute and case law principles rather than HMRC guidance. Where a dispute relates to particular facts the Commissioners will consider the evidence and make findings of fact to which they will apply the law.”

Comment

Although HMRC are saying in their Brief 01/07 that, so far as IR 20 is concerned, it is ‘business as usual’, this seems somewhat undermined by the argument presented before the Special Commissioners in Gaines-Cooper, where a rewriting of the extent of the taxpayer’s presence in the UK did not simply disregard days of arrival or departure. On the other hand, one might say that insofar as the 91-day test does not apply to someone who has been resident and ordinarily resident in the UK, this ceases to be so material. There the main point continues to be of course whether or not the taxpayer has ‘left’ the UK, which is typically rather more difficult to ascertain.

8. Residence and Domicile: The 2003 Review

The Paymaster General, Dawn Primarolo was asked what changes had been made to the residence and domicile tax rules in the light of the 2003 review. She answered that the ”review is ongoing.”

This review certainly has been going on for a long time.

Comment

The Review received its last official mention in the 2005 Budget, when we were promised a consultative document – yet to materialise. No mention was made at either Budget 2006 or the Pre-Budget Report in December 2006. While Dawn Primarolo’s answer might represent the official view, one might suggest that the subject has simply been parked in the ‘too difficult’ box.

9. Trusts Modernisation - Own Share Purchases: FB 2007 will Correct an Omission

Context

Dawn Primarolo has announced that the Government intends to bring forward legislation in Finance Bill 2007 to amend an omission which has been identified in the recent FA 2006 Trusts legislation.

The pre-2006 legislation did not tax a return of the subscription price

Certain types of capital receipts received by trustees are treated for tax purposes in their hands as income. This includes the case where the trustees of a settlement receive a payment made by a company buying back its own shares. In that situation, the original legislation in TA 1988 s686A provided that what was taxable was only the distribution element, and excluded the original subscription price received by the company which issued the shares.

FA 2006 subjects the entire payment to income tax

FA 2006 Sch 13 para 3 amended the existing TA 1988 s686A so that, in addition to its original function, it also introduces a common mechanism for the various types of capital receipt which are assessable to income tax in the hands of trustees receiving them to be charged at the special trust rates. There is, however, an omission in the wording of the new s 686A which has the result, in the situation of a buy-back of shares, that the whole of the payment by the company to the trustees including the original subscription price is taxable and not just the element representing the distribution.

FB 2007 will make a retrospective amendment

This result was not intended and therefore amending legislation in FB 2007 will amend TA 1988 s.686A. These amendments will be backdated to 6 April 2006 so that the position will be as it should have been from the start. HMRC have stated that they will consult on the amending legislation.

(HMRC press release 9.10.06)

Comment

It is clear that the original rule in F (No 2)A 1997 subjecting to income tax what was a capital receipt for trust law purposes applied only to own share purchases treated as a distribution (see TA 1988 s.686A before 2006/07). But the new s.686A, in its reference to 'payment', seems to catch also payments for which capital treatment applies under TA 1988 s.219(1).

The point about the application of new s686A to own share purchases treated on capital account under TA 1988 s619 seems generally to be agreed. It is thought that the point is going to be corrected in the future under the latest release of Tax Law Rewrite 4. However, surely, along with the omission agreed by Dawn Primarolo, this should be enacted by FB 2007 with effect from 6th April 2006. If not, then trustees selling shares back to a company where capital treatment applied today, would have to pay the rate applicable to trusts. The point is being pursued.

10. Settlor-Interested Trusts: Who Pays the Tax?

Context

Further to Item 12 in our Bulletin Autumn 2006, James Kessler QC has entered the fray with a posting on the Trusts Discussion Forum which questions the analysis adapted by HMRC – and indeed by many others.

The income of a settlor-interested trust still falls outside s686, as amended by FA 2006

Until 2006/07, a settlor-interested discretionary trust was not subject to tax at the special rate (formerly the additional rate) under TA 1988 s686. Section 686 made this clear:-

"(2) This section applies to income arising to the trustees of a settlement in any year of assessment so far as it.

(b) is not, before being distributed, either:-

(i) the income of a person other than the trustees; or

(ii) treated for any of the purposes of the Income Tax Acts as the income of a settlor."

It is James' understanding that the intention of the FA 2006 was that the trustees of such a trust should be subject to the special rate, so that:

(1) the trustees pay that tax on their income less allowable expenses;

(2) the settlor (if not a higher rate taxpayer) reclaims the tax paid by the trustees; and

(3) the settlor (if a higher rate taxpayer) pays higher rate tax on the part of the trust income which did not bear s686 tax (the expenses) and reclaims that from the trustees.

One might question the point of this change, which doubles or trebles the amount of work for trustees and settlors. But it seems to James that this result has not been achieved. Section 686 now provides:

"(2) This section applies to income arising to the trustees of a settlement] in any year of assessment so far as it –

(b) is not, before being distributed, …the income of a person other than the trustees."

The income of a settlor-interested trust is *'the income of the settlor, and of the settlor alone' (ITTOIA 2005 s624(1))*, so it still falls outside s686. The settlor pays the tax.

It requires a remarkably fierce purposive construction to reach any other conclusion.

(Trusts Discussion Forum 24.11.06 14.00 posting by James Kessler QC)

Comment

At present it seems that James Kessler is a lone voice in propounding the view that ITTOIA 2005 s624(1) prevents any liability at all for the trustees, whether at the lower, basic or rate applicable to trusts. However, James' view does seem persuasive, given the common use of the preposition 'of' in both s624(1) and s686(2)(b), to suggest that 'of' in the latter refers to all types of income whether actual or deemed. If so, there could be quite a neat analysis in the situation where you have a US resident settlor/beneficiary of a trust with UK resident trustees: there should be no income tax liability on anyone (other than at the dividend ordinary rate)!

11. Alternatively Secured Pensions: Pre-Budget Report Announces Anti-Avoidance Rules

Context

The Chancellor's Pre-Budget Report announced two broad categories of change.

Alternatively secured pension changes

Currently, the pension tax rules permit a member of a registered pension scheme who reaches the age of 75 to continue to draw an income directly from the pension fund sums and assets in the form of an ASP. Similarly, dependants of deceased members may also go into an ASP when they reach the age of 75. There is no requirement to draw a minimum income from an ASP fund and the maximum annual withdrawal is 70% of the annual amount of a comparable annuity (for a 75 year old) which could be purchased with the sums and assets in the fund. On death, any remaining funds may be used to provide dependants' pensions. If there are no dependants, then the funds may be paid to charity, transferred to the pension pots of other members in the scheme (as transfer lump sum death benefits) or in limited circumstances be repaid to the employer with a tax charge. FA 2006 introduced an IHT charge on ASP funds remaining on the member's death, which applies to any funds not paid as pension benefits to a relevant dependant or to charity.

Changes will be made to the tax rules on members' and dependants' ASPs to:

- introduce a minimum income requirement of 65% of the annual amount of a comparable annuity (for a 75 year old) which could be purchased with the sums and assets in the fund. Failing to comply with this requirement will mean that the scheme administrator will become liable to a 40% charge on the difference between the minimum income limit and the amount paid as pension income in the year;

- increase the maximum annual withdrawal of income permitted from an ASP fund to 90% of the annual amount of a comparable annuity (for a 75 year old) that could be purchased with the sums and assets in the fund;

- remove from the authorised payment rules the transfer lump sum death benefit option; this will impose an unauthorised payment charge of up to 70% where, on the death of a member or on the death of a dependant of the member, any remaining ASP funds are transferred to the pension funds of other members of the scheme;

- remove the facility to make payments under a guarantee from an ASP fund; and

- allow charity lump sum death benefits to be paid at the nomination of the scheme administrator, where there is no member nomination.

The FA 2006 IHT charges on ASP funds will remain. Apparently, the Government is considering how best to ensure that the rules work and interact correctly with the new unauthorised payment provisions. HMRC have stated that they will discuss this with interested parties.

Draft legislation has been published, intended to be in FB 2007, which sets out further details of these measures. HMRC have stated that they will discuss with interested parties what alternative provisions are needed for those cases where providers currently use ASP as a means to hold in suspense the funds of members which they have been unable to trace by age 75. According to the press release these discussions will take into account the need to minimise the costs of dealing with this group and also to ensure an appropriate outcome for the member.

Preventing other devices designed to pass on tax-favoured pension savings

The Government have announced that they will introduce measures in FB 2007 to prevent other pension options, such as scheme pensions, being used as a route to pass on tax-favoured pension savings. These measures will have effect after 5th April 2007.

HMRC have stated that they will consult with interested parties about the FB 2007 measures to ensure that they affect only those schemes or arrangements that are designed to pass on tax-favoured pension savings.

(HMRC press release PBRN 13 6.12.06)

Pre-Budget Report Notice 14 announced a number of technical improvements designed to ensure that:

- the pensions tax rules continue to meet the original intentions of the simplified regime;
- the generous tax reliefs for pensions are used to encourage individuals to provide for a retirement income; and
- industry costs in administering the pensions tax rules are reduced, wherever possible.

Comment

No particular surprises, we think. This merely represents further attempts by the Government to ensure that the ASP regime is not to be used for IHT avoidance.

12. Planning Gain Supplement (“PGS”): Pre-Budget Report Consultation

Context

The Pre-Budget Report 2005 announced a consultation on a new property tax on the increase in land value following the grant of planning permission. The last year has seen a firming up of the proposals, though the projected start date has been put back at least a year, to ‘not earlier than 2009’.

The Government has issued a consultation document entitled "Paying PGS: a Planning Gain Supplement Technical Consultation" which outlines the proposals, the major features of which are as follows:-

- A workable and effective PGS would not be introduced earlier than 2009;
- PGS would be levied at a modest rate across the UK;
- PGS would apply to residential and non-residential land;
- A significant majority of PGS revenues would be hypothecated for local infrastructure;
- PGS revenues generated in the devolved administrations would be returned to the country in which they were generated; and
- Transitional arrangements will aim to ensure that development already formally in the planning process would not be subject to PGS.

Responses are invited by 28th February 2007.

Comment

Introduction of the proposed Planning Gain Supplement has been put back a year – and there clearly remain a number of outstanding issues which have to be resolved. Obviously the question facing a number of landowners now contemplating development, and their advisers, is what forestalling provisions there may be to catch pre-2009 development.

NOTE: You should not act (or omit to act) on the basis of this Bulletin without specific prior advice.

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