McKie&Co

# TAX PLANNING BULLETIN

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## Introduction

HMRC has run a determined public relations campaign over the last few years to stigmatise tax planning (which it calls ‘tax avoidance’) as unethical and to suggest that it is in some way morally equivalent to tax evasion. This has coincided with a period in which HMRC’s ethical standards seem to have dropped alarmingly.

At point 3, we record a piece of particularly misleading ‘spin’ by HMRC. The Finance Bill contains a very general anti-avoidance rule governing all capital losses. Such rules are usually referred to as mini-GAARs (General Anti-Avoidance Rules) but HMRC’s explanatory material misleadingly refers to this as a Targeted Anti-Avoidance Rule. The rule is in fact so wide that it will catch much routine tax planning in the use of capital losses, including simple bed and breakfast transactions, a fact which HMRC’s explanatory notes deny.

At point 4, we record a belated climb down by HMRC in respect of whether or not bare trusts are settlements for the purposes of Inheritance Tax in which they have abandoned a position which they should never have adopted.

At point 5, we record HMRC’s belated acceptance of an analysis of the Inheritance Tax effects of reversionary leases which had been clear to tax advisers for many years; an acceptance which has been made only because it enables HMRC to impose a pre-owned assets charge on the arrangements. They announced their damascene conversion on 29th January 2007 giving tax payers just two days to take account of the changed view in deciding whether or not to make an election for GWR treatment under FA 2004 Sch 15 para 21.

In our last bulletin we recorded HMRC’s behaviour in *Gaines Cooper v HMRC* where the department successfully presented an argument which contradicted its owned practice published in IR20. At point 7, we now record HMRC’s claim that its position in *Gaines Cooper* was in fact consistent with IR20 and show why that claim is false.

With such behaviour by HMRC, it is ever more important for taxpayers and their advisers to receive exact, unbiased and robust advice from specialists. That advice should carefully distinguish HMRC’s published statements of the law from the law itself and take a realistic view of HMRC’s likely response to tax planning.

**Sharon McKie** **Simon McKie**

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# INDEX

# A. CAPITAL GAINS TAX

## 1. Avoidance: Share for Share Exchange

***Context***

The issue in this case was whether TCGA 1992 s137 prevented the application of s135 under which the gain which would otherwise have arisen at the time of the exchange of shares for loan stock was deferred until redemption of the loan stock.

***Snell v HMRC: the facts***

Mr Snell owned 91% of the shares in a company which he exchanged in return for three different types of loan stock in December 1996. In April 1997 he emigrated to the Isle of Man, after which he became non-resident and not ordinarily resident in the UK for tax purposes. He then redeemed the loan stock. When he failed to declare the gain on the disposal of the shares in his 1996/97 tax return, HMRC issued an amendment to include a sum in respect of CGT on the gain.

Mr Snell appealed to the Special Commissioners arguing that by virtue of TCGA 1992 s135, the gain was deferred until the loan stock was redeemed. Because he was not resident in the UK when the loan stock was redeemed he was not subject to UK CGT. HMRC contended that s135 did not apply as the taxpayer did not satisfy the two limbs of s137 which provided that s135 did not apply to any issue by a company of its shares or debentures in exchange for, or in respect of, shares in or debentures of another company, unless the exchange, reconstruction or amalgamation in question was effected for *bona fide* commercial reasons and did not form part of a scheme or arrangements one of the main purposes of which was avoidance of CGT or corporation tax.

The Special Commissioners determined that the exchange by Mr Snell of his shares in the company for the three separate classes of loan stock to the aggregate value of £6,580,000 was 'effected for *bona fide* commercial reasons', but that such exchange did '*form part of a scheme or arrangements of which the main purpose, or one of the main purposes, [was] the avoidance of liability to capital gains tax*'. Accordingly they concluded that TCGA 1992 s135 and ss127 - 131 did not apply, with the consequence that Mr Snell was liable for CGT. Mr Snell appealed from the second of those conclusions and HMRC from the first.

***The decision (ChD: Warren J)***

***Was the share exchange effected for* bona fide *commercial reasons?***

The purpose of s137 was to limit the application of ss135 and 136. Sections 132 - 134 applied s127 - 131, with modifications, to the conversion of securities. There was no suggestion in any of those provisions that the reason for the reorganisation or conversion, as opposed to its genuine occurrence, was relevant to the enjoyment of the relief for which s127 provided.

Sections 135 and 136 applied those provisions to exchanges of securities, whether involving a scheme of reconstruction or amalgamation or not, in which more than two persons were involved. In such circumstances it was necessary for the exchanges to be for commercial reasons if the new and the old holdings were to be treated as the same. But if there was appropriate identity and value commensurate with *bona fide* commercial reasons, there was no reason why Parliament should have been concerned with whether the same result might have been achieved by some other legal form or means. That was particularly so when the same subsection introduced a non-avoidance test by reference to the scheme or arrangements as a whole. That conclusion was confirmed by the wording of the subsection. The question was whether 'the exchange in question had been effected '*for* bona fide *commercial reasons*'. If the answer was in the affirmative it was irrelevant to consider the reasons why the parties chose to structure their transaction in that way. Accordingly, HMRC's cross-appeal was dismissed.

***Was the exchange part of a scheme or arrangements of which the main purpose, or one of the main purposes, was the avoidance of liability to capital gains tax?***

The ordinary meaning of the word 'scheme' was '*a plan of action devised in order to attain some end'*. Similarly an arrangement was *'a structure or combination of things for a purpose'* (see the *Shorter Oxford English Dictionary).* Accordingly, unless the taxpayer had the purpose of becoming non-resident as at 21st December 1996 so as to link the acceptance of loan notes on that day with their redemption when non-resident after 5th April 1997 there could not be a relevant scheme or arrangement for the purpose of s137.

There was no misdirection and the evidence was more than sufficient to justify the inference that the Special Commissioners drew. If that was the scheme or arrangements then a main purpose was, subject to a point of construction on which Mr Snell relied, the avoidance of a liability to CGT, for there could have been no other. Thus there was no reason to remit the matter to the Special Commissioners to find further facts. Section 137 was concerned with the terms on which a liability to CGT might be deferred. It provided for a right of deferral to be lost if it was to be used for the purpose not of deferral but of avoidance altogether. If that was a main purpose of the scheme or arrangements, it mattered not whether the scheme, etc. was formed for purposes of tax mitigation, avoidance or indeed evasion. The plain fact was, as the Special Commissioners had recognised, that the main purpose of the scheme was the avoidance of a liability to CGT.

The essential point was that the word 'liability' in s137(1) could not be limited to an actual liability. By definition such a liability could not be avoided, only evaded. Accordingly the liability to CGT had to include a contingent or prospective liability. It might be that the context in which the phrase was used could limit its ambit in relation to prospective liabilities. However, in a context, such as this, where liability might be deferred on certain conditions, there was no reason to restrict the ambit of the word 'liability' so as to exclude that which had been deferred.

Accordingly, the exchange was part of a scheme or arrangements of which a main purpose was the avoidance of liability to CGT. Mr Snell's appeal was dismissed.

*(CCH Taxes Weekly Tax News Issue 434 15.1.07 p34)*

***Comment and application***

Interestingly, the facts of this case occurred some ten years ago. Clients need to be made aware (and warned?) that if a particular matter goes to the Courts it could be ten years or more before a decision is made - and then on the basis not so much of the then current law (which would be that applying at the relevant time), but rather of the then perception of the law, specifically judicial attitudes to avoidance which might well have hardened in the interim.

There is perhaps a worrying statement in the summary of the decision: *'S137 was concerned with the terms on which a liability to CGT might be deferred. It provided for a right of deferral to be lost if it was to be used for the purpose not of deferral but of avoidance altogether.'* The words *'avoidance altogether'* presumably refer to a situation where, as in this case had the arrangement been successful, no tax would have been paid at all. However, presumably, a case where a liability is simply pushed into the subsequent tax year would not be avoidance, albeit carrying the benefit of delaying the payment of tax by twelve months (or indeed more, if the disposal is shifted from the end of one tax year to the beginning of the next). Suppose one deferred a liability into a year where one knew that allowable losses would arise: would that be *'avoidance altogether'*?

While this case underlines the importance of the right advice being given (and bear in mind the embarrassing disclosures made through the two or three box files of documents produced before the Special Commissioner), an adviser does have ethical duties to his or her professional body, not to mention the obligations to the client. A solicitor with legal professional privilege might be in a better position than an accountant. But one should beware any temptation not to put advice in writing (and oral advice must be uncertain), as the question then always becomes (whether from the client or HMRC or the Court) *'Why was it not put in writing?'*.

The big practical problem, for taxpayers and their advisers is that if any planning is put in place with a view to achieving what HMRC would term *'avoidance altogether'*, the taxpayer is left with having to try to prove a negative. It will be very difficult in many situations for a taxpayer to show on an objective basis that he indeed had no particular plan at a given date.

## 2. Reverter to Settlor Trusts: Can the Twin IHT and CGT Advantages Still be Secured under the 2006 Regime?

### *Context*

Reverter to settlor relief (IHTA 1984 s53(3)) under the 2006 IHT regime for trusts depends upon the trust property reverting outright, rather than on a continuing trust, which would, unless it was a transitional serial interest (TSI), fall into the relevant property regime. But the CGT-free uplift to market value on death can be obtained only if there is a continuing trust (TCGA 1992 s73(1)(b)). So, failing the TSI analysis with death of the life tenant before 6th April 2008, one must generally decide (while the life tenant is alive) between the balance of advantage as between IHT and CGT. If, as is likely, the IHT advantage is preferable, the terms of the trust should be changed on 6th April 2008 to provide for an outright reverter.

### *IHTA 1984 s53(4) to the rescue*

However, if on the death of the life tenant, the property reverts absolutely to either the UK domiciled spouse of the settlor or, where the settlor has died within the last 2 years, the UK domiciled widow or widower, there is still freedom from IHT. But the CGT-free uplift is secured, as TCGA 1992 s73(1)(b) refers only to the settlor.

While the TSI point remains should the life tenant die before 6th April 2008, it is suggested that on that day the trusts are changed to provide (other things being equal, as between the spouses) for an outright reverter to the named spouse. If the settlor dies more than 2 years before the life tenant, the tax position is no worse than it would have been otherwise.

### *Comment*

Obviously, where the trust fund comprises a dwelling, this mechanism would be unnecessary if it was possible to obtain PPR relief on a sale of the house 36 months after it had ceased to be used as such by the beneficiary, typically on his death. (Note that this would presuppose a sale by the trustees either before the life tenant's death or in the event of continuing trusts following it. If the trust came to an end on the death, it would be the settlor who made the disposal, ie with no uplift in base cost to market value on the life tenant's death and with no PPR relief.)

However, in any other case, for example, where the trust fund is comprised of property not attracting PPR relief or was stocks and shares, the suggestion is a good one. In the case of settled intangible property, the issue of a pre-owned asset income tax liability for the settlor should be considered. It would be excluded if it was only the spouse who could benefit.

Might the idea be vulnerable to attack under general avoidance principles? The answer should be no. First, because no IHT was being avoided, nor indeed CGT: rather, one was simply ensuring a higher base cost than might otherwise have been available. More generally, however, there is no reference to tax avoidance in the relevant sections and so the point should not arise.
There would of course be a problem with the suggestion if the spouse were to predecease the settlor. However, one could then, subject perhaps to a remarriage (!), reintroduce the settlor as the absolute beneficiary on termination of the life interest – and one would be no worse off.

## 3. Finance Bill 2007: A Targeted Anti-Avoidance Rule

A targeted anti-avoidance rule (TAAR) has been introduced in Finance Bill 2007 to counter schemes to create and use artificial capital losses to avoid tax. HMRC claim that the measure will ensure that allowable capital losses are restricted to those arising from genuine commercial transactions.

The changes will take effect in relation to capital losses arising on disposals after 5th December 2006, except in relation to corporation tax where an equivalent rule already has effect.

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 (TCGA 1992 s16).

An express exception to this general TCGA rule was introduced in FA 2006. A 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 their main purposes (TCGA 1992 s8). The intention of that provision is to deter the creation and use of artificial capital losses by companies liable to corporation tax on their chargeable gains.

This measure will extend that anti-avoidance rule for companies to persons liable to CGT (individuals, trustees and personal representatives). Where a person has entered into arrangements, and a main purpose of those arrangements 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.

*(HMRC news release BN 30 21.3.07)*

***Comment***

While HMRC's guidance on the TAAR suggests that it is aimed only at contrived arrangements, the difficulty is that the TAAR is very widely drafted and the guidance has no statutory authority. While HMRC have said that they do not intend to apply the TAAR to what one might call standard CGT mitigation arrangements, it is hard to see that something like ‘bed and spouse’ or ‘bed and ISA’ is not caught by the strict wording of the draft legislation. Advice given in this area needs to be qualified by appropriate caveats – at least until things have become clearer.

# B. INHERITANCE TAX

## 4. Bare Trusts for Minors: IHT Analysis

***Context***

HMRC's response to an apparently straightforward question (33) within the COP 10 Questions put by STEP and CIOT on FA 2006 Sch 20 (*'We are seeking advice from our solicitors on this point'*) has caused some consternation. HMRC have, however, recently confirmed that they accept that a bare trust for a minor (regardless of whether Trustee Act 1925 s31 is excluded) will not be a substantive settlement.

***STEP Briefing***

HMRC have confirmed that where assets are held on trust for a minor absolutely, such a trust will not be treated as a settlement for IHT purposes under IHTA 1984 s43(2).

Following the changes to IHT introduced by FA 2006, in previous correspondence with professional bodies, HMRC had cast doubt over the correct IHT treatment of bare trusts for minors, giving rise to concerns that property held for minors would be relevant property within the expanded discretionary trust regime. Those doubts have now been dispelled and HMRC have indicated that they concur with the strongly held view of the representative bodies that no distinction should be drawn between bare trusts for minors and those for adults.

The practical consequences of this are:-

- it is now possible to exit the relevant property regime by an outright appointment to a minor; and
- there is no continuing uncertainty that gifts to minors will constitute potential exempt transfers ("PETs") outside the relevant property regime.

HMRC had previously suggested in December 2006 that *'it is arguable that it [a gift held for a minor] would be a [settlement] …. within s.43 (2) IHTA'*. This argument was based on the effect of Trustee Act 1925 s31 which, during the minority of a beneficiary, gives trustees a discretion to apply the income of the trust fund for the maintenance, education or benefit of that minor beneficiary. The effect of this would have been that it was not possible to make a PET to a minor and that all funds held for minors would have been treated as relevant property, subject to the principal and proportionate charges.

HMRC are consulting with regard to issuing more detailed guidance on this point, which is expected shortly.

*(STEP Briefing 23.3.07)*

***Comment***

This climb-down is an excellent response to some vigorous technical analysis by STEP and CIOT. It is a sensible and correct outcome. Of course, whether it is a good idea to put substantial sums (even if not exceeding the nil-rate band) into a bare trust for a minor child is quite another question…

## 5. The Pre-Owned Assets Regime: HMRC 'Change of Heart' on Reversionary Leases

***Context***

HMRC's Technical Guidance on the POA regime has most recently been warning that they were reconsidering the position of reversionary leases. Previously HMRC had confirmed that leases made after 8th March 1999 were caught by the anti-*Ingram* changes to FA 1986 and so were within the GWR regime and as such outside the POA regime. This was not a view generally taken by professional advisers. Now, however, HMRC have adopted the generally held view – and for precisely the reasons put forward by the professions!

The statement was originally issued on 29 January 2007, but was revised on 8th March 2007 (the changed words being underlined below).

***The (further) revised HMRC view***

*A reversionary lease scheme, typically, is an arrangement where a donor grants a long lease of his property for say 999 years to the proposed donee, and the lease does not take effect until some future date. An example of this would be where Mr V, who has owned his house since 1990, grants a 999-year lease to his daughter in 1998 but not to take effect until 2018. Mr V continues to occupy the property.*

*Such schemes entered into before 9 March 1999 are not gifts with reservation of benefit <u>so long as the lease contains no terms that are beneficial to the donor (see example below),</u> and the income tax charge will apply.*

*For reversionary lease schemes entered into on or after 9 March 1999 HMRC had previously held the view that section 102A Finance Act 1986 would apply because the donor's occupation would be a 'significant right in relation to the land'. If that analysis were correct, the reservation of benefit rules would apply and there would be no income tax charge. However, HMRC now consider that where the freehold interest was acquired more than 7 years before the gift, the continued occupation by the donor would not be a significant right, and <u>therefore contrary to its previously held view, s102A cannot apply to the gift because of s102A(5).</u>*

*If the donor grants a reversionary lease <u>within 7 years of acquiring the freehold interest, section 102A may apply to the gift depending on how the remaining provisions of that section apply in relation to the circumstances of the case.</u>*

*<u>Bear in mind, however, that, whenever the freehold interest was acquired, a gift may be a gift with reservation of benefit under section 102 FA 1986</u> if the lease contains terms beneficial to the donor. An example of this may be where the lessee covenants to pay the costs of maintaining the property.*

*Where the GWR provisions do not apply it will nevertheless be regarded as a disposal of an interest in the relevant land under paragraph 3(2) of Schedule 15, and the charge to income tax will apply, calculated in accordance with the formula in paragraph 4(2), unless the donor elects into the reservation of benefit provisions.*

*(HMRC revised guidance on pre-owned assets 8.3.07)*

***Comment***

Although the issue of the original statement on 29 January 2007 hardly gave much time to those subject to a POA charge for 2005/06 who might have wanted to elect into GWR rules before 31 January 2007, there is a further twist. While form IHT 500 for electing into GWR and explanatory notes were published on HMRC's website in 2006, no regulations prescribing the manner in which the election is to be made had been passed (see FA 2006 Sch 20 para 21(2)).

HMRC's response in BN 28 was to announce, not only for 2005/06 but for all years, that HMRC would be given power to accept late elections (FB 2007 clause 65). The difficulties, however, are twofold. First, we are not told anything about the circumstances in which HMRC will allow late elections. Secondly, it is unclear what those who did elect into GWR by 31 January should now do in terms of validity of those elections: are they to be confirmed, once regulations have been promulgated? HMRC need to clarify this. Alternatively, if for example having made the election the taxpayer then unexpectedly died, it would presumably be possible to argue that no valid election had been made and that GWR did not apply, merely a POA income tax charge for 2005/06.

# C. STAMP DUTY LAND TAX

## 6. Finance Bill 2007: Some Salient Points

***Exchange of Property Between Connected Persons (BN 21 and FB 2007 clause 75)***

If there is an exchange of property, any money moving between the two parties is ignored and SDLT is charged by reference to the market value of the property acquired (FA 2003 s47).

However if the parties are 'connected persons', for example as husband and wife or brother and sister, there is a further rule because the two elements of the exchange are 'linked transactions'. This means that the market values are aggregated and the rate of SDLT is that applicable to the aggregate. So if property worth £300,000 is exchanged for property worth £220,000 the rate of SDLT on both legs is 4%, the rate applicable to £520,000.

FB 2007 provides that the two elements of an exchange will not be linked with each other. So in the example above there will be a charge at 1% on the acquisition of the property worth £220,000 and a charge at 3% on the acquisition of the property worth £300,000.

***S75A: Anti-Avoidance Measures (BN 22: FB 2007 clause 70)***

Finance Bill 2007 includes provisions replacing, with amendments, the SDLT (Variation of the FA 2003) Regulations 2006 (2006 SI No 3237).

This change will have effect for any transaction the 'effective date' of which is on or after the date on which Finance Bill 2007 receives Royal Assent. The effective date is normally the date of completion, not the date of exchange, of contracts. However, the effective date may be earlier than the date of completion if the contract is 'substantially performed', for example, if the purchaser takes possession or pays the purchase price in advance of completion. Most residential contracts will not be 'substantially performed' in advance of completion.

On 6th December 2006 HM Treasury made the SDLT (Variation of the FA 2003) Regulations 2006 (2006 SI No 3237) to counter SDLT avoidance schemes were passed and approved by the House of Commons on 15th January 2007. However, the Regulations have effect only for 18 months from the date they were made. The Government has therefore decided to replace the Regulations by permanent provision in Finance Bill 2007.

The Finance Bill provision incorporates a number of changes to the Regulations to take account in particular of representations made.

***Comment***

The new rule for exchanges is welcome and sensible as it has been a point that had troubled many practitioners.

There continues to be huge uncertainty about the scope of new s75A which has applied since 6 December 2006. One can only wait on further clarification. Meanwhile the draft guidance released by HMRC on 24 January 2007 gives the following 'comfort':-

> "*HM Revenue & Customs will accept that the 2006 Regulations may be applied subject to the following guidance:*

- *A construction contract is not a scheme transaction in relation to a land transaction where the circumstances are such that, by virtue of the decision in* Prudential Assurance Co Ltd v IRC *[1992] STC 863 (see SDLTM04015), the consideration properly attributable to the construction contract is not part of the chargeable consideration for the land transaction.*
- *The carrying out by a person other than the vendor of works of construction, improvement or repair of a building or other works to enhance the value of land is not a scheme transaction in relation to the purchase of the land.*
- *The purchase of assets other than land is not a scheme transaction in relation to a land transaction where the provisions of paragraph 4 of Schedule 4 Finance Act 2003 apply to the apportionment of consideration between the purchase of assets and the land transaction.*
- *A transfer of shares in a company or units in a unit trust which is not preceded by any land transaction in relation to which it might be a scheme transaction is not a scheme transaction in relation to any subsequent land transaction.*
- *A loan from a person who is not a party to any other scheme transaction to fund the purchase of property is not a scheme transaction in relation to the purchase of the property.*
- *Where a land transaction qualifies for reconstruction relief or acquisition relief the issue of shares under paragraph 7(2) or 8(2) of Schedule 7 Finance Act 2003 is not a scheme transaction in relation to that land transaction.*
- *Where the only transactions are the transfer of a number of properties into a partnership by partners, none of the transfers is a scheme transaction in relation to any of the other transfers.*
- *Where the only transactions are the purchase of land and a lease (or leases) of all or part of the land to a person not connected with the purchaser of the land, the purchase is not a scheme transaction in relation to the lease(s) and* vice versa.”

# D. MISCELLANEOUS

## 7. *Gaines-Cooper*: HMRC's Response

***Context***

Following the decision in *Gaines-Cooper v HMRC* (see Bulletin Issue No. 19 Winter 2006, Item 17), HMRC have published their response to the decision. So far as HMRC are concerned, it is 'business as usual', certainly so far as the application of the principles set out in the long-established IR20. The text of HMRC Brief 01/07 is set out below followed by one or two comments on the relationship to IR20.

***HMRC Brief 01/07***

*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.*

*(HMRC Brief 01/07 4.1.07)*

***Comment***

IR20 states *inter alia* the following:

*'1.2…The normal rule is that days of arrival in and departure from the UK are ignored in counting the days spent in the UK, in all the various cases where calculations have to be made to determine your residence position - see for example paragraphs 2.2, 3.3 and 3.4 and the examples in 2.10 and 3.6. (This rule is not relevant to the concessionary split year treatment described in paragraphs 1.5 -1.6, where a person coming to or leaving the UK part way through a tax year is resident from the date of arrival or to the date of departure.)'*

What is interesting about the above is that the reference to para 2.2 explicitly brings in section 2 which is concerned with leaving the UK, even though 'the example' of 2.2 itself deals with working abroad. Line 3 of the above extract refers to 'all' the various cases.

> **"*Leaving the UK permanently or indefinitely***
>
> *2.7 If you go abroad permanently, you will be treated as remaining resident and ordinarily resident if your visits to the UK average 91 days or more a year - see paragraph 2.10. Any days spent in the UK because of exceptional circumstances beyond your control, for example the illness of yourself or your immediate family, are not normally counted for the purposes of averaging your visits.*
>
> *2.9 If you do not have this evidence, but you have gone abroad for a settled purpose (this would include a fixed object or intention in which you are going to be engaged for an extended period of time), you will be treated as not resident and not ordinarily resident from the day after the date of your departure providing*
>
> - *your absence from the UK has covered at least a whole tax year, and*
> - *your visits to the UK since leaving*
>
>   *- have totalled less than 183 days in any tax year, and*
>   *- have averaged less than 91 days a tax year.*
>
> *If you have not gone abroad for a settled purpose, you will be treated as remaining resident and ordinarily resident in the UK, but your status can be reviewed if*
>
> - *your absence actually covers three years from your departure, or*
> - *evidence becomes available to show that you have left the UK permanently*
>
> *providing in either case your visits to the UK since leaving have totalled less than 183 days in any tax year and have averaged less than 91 days a tax year.*"

Therefore, although the 90-day test is mentioned as relevant in testing departure from the UK, the key thing, as mentioned both by Dr Brice in *Shepherd* and by Dr Brice and Charles Hellier in *Gaines-Cooper,* is whether the going abroad is '*for a settled purpose'* or, if not, then permanent. There is therefore something of a conflict in HMRC's views, though they do seem to follow the '*days of arrival and departure*' principle in deciding whether a person has left the UK (see paragraph 1.2 in applying the last paragraph of 2.9).

A key point which was not properly covered in the decision was the status of the *'available accommodation'* rule. The Government, in its 1993 Budget, announced its intention to abolish this rule, but this was not carried through. The legislation merely amended TA 1988 s336, to the effect that accommodation is to be disregarded in determining, for the purposes of that section, whether the individual is in the UK for some temporary purpose and not with a view to establishing residence.

As to the law, the Special Commissioners were clearly entitled to disregard days of arrival and departure and to find Mr Gaines-Cooper to have been UK resident in all the years at issue **unless** the 1993 changes abolished the available accommodation rule. Should the case go on appeal to the High Court and the High Court decide that the rule has been abolished, Mr Gaines-Cooper's status will fall to be judged against the old cases involving long-stay visitors to the UK who stayed in hotels. And here there is a distinction between cases where the individuals were leaving the UK *(Levene* and *Lysaght)* and those of foreigners or long-term absentees coming to the UK *(eg Zorab* and *Kinloch)* where a much higher day count is permissible. Although HMRC seem to have taken the view that Mr Gaines-Cooper had always been UK resident, this is not clearly the case and there is an argument that he had been resident in the Seychelles (and not the UK) in the 1970's and in California (and not the UK) in the 1980's.

Finally, if the Court decides that FA 1993 failed to abolish the accommodation rule, but (improbably?) accepts that Mr Gaines-Cooper should be entitled to rely on IR20, there is an issue as to whether Mr Gaines-Cooper should be able to claim 'exceptional circumstances' in the years where his day count went over the 91-day average. But that then becomes a public law, not a tax law, matter.

All in all, therefore, not an open and shut case! However, will it go to the High Court on appeal? It will be interesting to see how the case develops. Meanwhile, more than unusual care is needed in advising clients, especially long-term residents wanting to become both resident and ordinarily resident outside the UK.

## 8. Construction Industry Scheme: A Catch for Residential Investors

### *Context*

The new CIS which commenced on 6th April 2007 has been well publicised. While there is an exemption for owners having work carried out on their own homes, there is no such exemption for other residential property. A catch to be aware of.

Long-term investors will not need to register unless they are a 'deemed contractor.' This requires expenditure of £1 million a year over three years – in most cases this is unlikely.

However, 'small-time' property developers (eg those who buy a property and hire builders to carry out improvements prior to resale) will need to register as contractors and comply with the procedures when paying builders. Registration also appears to extend to 'investors' who change their minds (ie they gain vacant possession and then hire builders to carry out improvements prior to sale).

***Comment***

This is a curious example of one (new) tax regime having a disproportionate impact on 'ordinary' taxpayers. But 'forewarned is forearmed'.

## 9. Beneficial Loan Interest Rate Increase

***Context***

The 'official rate' of interest is relevant not just to measuring the tax charge on interest-free or low interest loans made to employees by reason of their employment. It applies also under the POA income tax regime to fix the annual charge in relation to chattels or settlor-interested trusts of intangibles.

**Increase to 6.25% from 6.4.07**

This new rate replaces the 5% which has been in place since January 2002.

*(The Taxes (Interest Rate) (Amendment) Regulations [2007] SI 2007/684)*

***Comment***

Of course, an increase had to happen sometime, in the context of current market rates. But we had got so used to the 5% prevailing for more than five years! However, one must consider the impact for those who had ensured that the amount charged under POA for chattels or settlor-interested trusts was no more than say, £100,000 per taxpayer, producing a POA charge of £5,000 – nicely inside the *de minimis* limit. Now, from 2007/08, the amount charged will rise to £6,250 all of which is subject to income tax.

## 10. Tax Avoidance with Manufactured Interest Payments: Successful Exploitation of the Legislation

***Context***

In the current debate about the distinction between unacceptable tax avoidance and acceptable tax mitigation, an interesting High Court case has been published, albeit that (unsurprisingly) the particular arrangement found to be successful has since been blocked by legislation.

***HMRC v D'Arcy: the facts***

D entered into a tax avoidance scheme involving transactions in gilts, designed to create a tax deduction for a manufactured interest payment. HMRC issued a closure notice on the basis that the deduction was not allowable: they subsequently accepted that the deduction was allowable, but argued that D was taxable on an amount approximately equal to the deduction under the accrued income scheme. D appealed, contending that the effect of TA 1988 s710(6) was that the sale and repurchase were both deemed to have taken place on the same day, so that the effect of s710(7)(b) was that she should be deemed never to have held the securities for the purpose of the accrued income legislation.

The Special Commissioner accepted this contention and allowed the appeal, holding that *'any charge on the sale under the accrued income scheme is excluded by s715(1)(b) because on no day was the appellant entitled to any gilts as defined by the accrued income scheme'*. The Special Commissioner also rejected an alternative HMRC contention based on s715(6), approving the explanation of s715(6) in *Simon's Direct Tax Service,* para A7.520, and holding that *'the purpose of s715(6) is merely to avoid a double charge first under the manufactured payment rules and secondly under the accrued income scheme. It achieves this by deeming there to have been no transfer for the purposes of the accrued income scheme, so that the scheme does not apply. The provision cannot be used to create a charge under the scheme.'* HMRC appealed to the ChD, which upheld the Special Commissioner's decision.

***The decision (ChD: Henderson J)***

Upholding the Special Commissioner, the effect of s710(7) was that 'the vendor ceases to be entitled to the securities which he has agreed to sell at the moment when he first becomes entitled to them'.

Henderson J observed that *'it is a striking feature of the tests for holding securities 'on a day' in s710(7)(b) that they will not be satisfied if entitlement to the securities ceases during the day, whereas they will be satisfied if entitlement to the securities continues throughout the day, or if entitlement begins during the day and then continues for the rest of the day'.*

He concluded that *'the accrued income scheme does not throw up a charge to counterbalance the deduction admittedly available to D for her manufactured interest payment. But the accrued income scheme and the provisions relating to manufactured interest were enacted at different times and with different statutory purposes. They do not form part of a single unified code, and their separation is indeed emphasised by section 727A. In short, this is in my view one of those cases, which will inevitably occur from time to time in a tax system as complicated as ours, where a well-advised taxpayer has been able to take advantage of an unintended gap left by the interaction between two different sets of statutory provisions.'*

*(The Tax Journal 12.2.07 p5)*

***Subsequent statutory reversal***

TA 1988 Sch 23A was subsequently amended by FA 2004 to close the loophole which was exploited by this scheme.

***Comment***

This decision is fascinating in the context of the current debate about the distinction between unacceptable tax avoidance and acceptable tax mitigation. Although the arrangement in this case may seem rather an arcane one, both the Special Commissioner and now the High Court have upheld the fiscal effectiveness of what the taxpayer did. Anomalies are bound to occur in the tax legislation and to take advantage of them for a purpose unintended by the legislature cannot be regarded as unacceptable tax avoidance. HMRC may disagree. But certainly that activity would seem to fall within the dictum of the late Lord Nolan in *Willoughby* viz *'The hallmark of tax mitigation… is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option.'*

The point is very similar to that which arose in *Davies v Hicks* (see Bulletin No. 14 (Summer 2005), Item 2), where the taxpayer successfully took advantage of the anti-bed and breakfasting share identification rule in TCGA 1992 s106A to avoid the emigration charge on exporting a trust. As in the *D'Arcy* case the loophole was subsequently closed by legislation.

## 11. Trustee Act 1925: The Meaning of 'Individual'

***Context***

The issue in this case was whether for purposes of Trustee Act 1925 s37(1)(c) a trustee would be properly discharged, on the basis that a company was an 'individual'.

***Jasmine Trustees Ltd and Others v Wells & Hind (a Firm) and Another: the facts***

The family settlement was constituted by Major-General and Mrs Coaker, both of whom were resident in the UK. In 1982 the Coakers purported to resign and appointed the Investment Bank of Ireland (IOM) Ltd and a Mr Thornton, both of whom were resident overseas, to be sole trustees.

Thereafter, the purported trustees appointed replacement trustees, all of whom were resident overseas, who made resolutions and declarations on the footing that they had been validly appointed. The defendant firms had acted in the drawing up of various documents during the relevant period.

A remedial appointment of the first and second claimants, both trust corporations, was made in 2002 because of concerns over the effectiveness of the 1982 deed of appointment.

Subsequently, the Inland Revenue raised CGT assessments against the first and second claimants for each of the years 1989 to 1997 on the basis that the majority of the trustees were resident in the UK.

Those assessments were raised under the 1979 Act and the 1992 Act, which were relevant to different periods of the life of the trust.

By virtue of s52 of the 1979 Act and s69 of the 1992 Act, the wording of which was the same: '*the trustees of the settlement shall be treated as being resident and ordinarily resident in the United Kingdom*'.

The claimants brought proceedings against the defendant firms on the basis of professional negligence for damages in the amount of tax due.

***The decision (ChD: Mann J)***

A company was not an 'individual' in the context of the Trustee Act 1925 s37(1)(c), which provided that a trustee would not be discharged from his duties unless there was either a trust corporation or at least two individuals to take over the trust, since 'individual' meant 'natural person'.

Mann J said that, since the original trustees purportedly appointed a company and an individual, instead of two individuals or a trust corporation, the original trustees had not been discharged from their duties.

Therefore: (i) the trustees of the settlement were ordinarily resident in the UK, so that the trust was onshore for tax purposes; (ii) various trustees purportedly appointed during the relevant years were not 'trustees of the settlement' under CGTA 1979 s52 and TCGA 1992 s69; and (iii) various resolutions made during the life of the trust were invalid and ineffective.

*(Jasmine Trustees Ltd and Others v Wells & Hind (a Firm) and Another 19.1.07 The Times Law Reports 12.2.07)*

***Comment***

There could be very worrying implications of this decision, even in an all UK situation, if the old trustees had not been properly discharged and so, on the basis of Trustee Act 1925 s37(1)(c), the new trustees are not even constructive trustees. This would mean that any CGT paid over what could be quite a long period of time had not been paid by the 'proper' trustees (even if by concession HMRC were prepared to allow set off against the proper trustees' liability), with failures as to self assessment etc.

This could arise if for example (a) the wrong power was used in a power of appointment; (b) the written consent of the settlor or protector was required and had not been obtained, either at all or in the prescribed manner; or (c) the old trustees had become non-UK resident after 'retiring', but then found that they were still trustees and that emigration had inadvertently triggered an exit charge.

Any distributions of capital made by the new improperly appointed trustees would be invalid – and so on. Something of a nightmare scenario…

## 12. Finance Bill 2007: Matters Foreign

### Taxation of Personal Dividends

Dividends received by individual shareholders are taxed at rates of 10%, 10% and 32.5% for lower rate, basic rate and higher rate taxpayers respectively.

The changes proposed will, from 6th April 2008, extend the non-payable tax credit of one ninth of the distribution to individuals in receipt of dividends from non UK-resident companies, subject to certain conditions. A person will qualify for the non-payable dividend tax credit if they own less than a 10% shareholding in the distributing non UK-resident company, and in total they receive less than £5,000 of dividends a year from non UK-resident companies.

The Government is also considering whether it is possible to extend the non-payable tax credit, without creating scope for abuse, to the small minority of individuals who do not meet the conditions outlined above.

### Homes Abroad Owned Through a Company

The Government has announced its intention to bring forward legislation in Finance Bill 2008 which will ensure that individuals who have bought or will buy a home abroad, will not face a benefit in kind tax charge for any private use of the property if purchased through a company.

Some UK resident individuals have set up or acquired companies to own a property abroad, generally for holiday use. Where they direct the company's affairs (whether through an agent or not) they can be within the scope of the living accommodation charge, although they may not have been aware of this or may have considered that no tax or NICs charge arose in these circumstances (and have not, therefore, reported the matter to HMRC).

The legislation will ensure that all those who come within its scope will not face the benefit in kind tax charge – however long they have owned the property through a company.

Chapter 5 of the Income Tax (Earnings and Pensions) Act 2003 sets out the tax position when accommodation is provided by an employer. Unless covered by a specific exemption a tax charge can arise where a property is provided by an employer to their employees, or to a director, when the property is available for their use.

The exemption will only apply to the benefit in kind charge. It will apply where an overseas property is owned by a company that is owned by individuals and whose sole activity is holding that property for occupation and/ or letting. It will have retrospective effect.

Draft legislation will be published for consultation later this year. HMRC will not seek to tax anyone in the intervening period where the following conditions are met:

- The property is owned by a company owned by individuals;
- The company's only activities are ones that are incidental to its ownership of the property;
- The property is the company's only or main asset; and
- The property is not funded directly or indirectly by a connected company.

***Comment***

It is good to end this Tax Planning Bulletin with good news. Do bear in mind the conditions which must be satisfied to get the advantage of the tax credit for non-UK dividends.

Secondly, do note that BN 50 applies only to houses outside the UK. The spectre of a beneficial accommodation income tax charge continues to apply with UK homes in circumstances where HMRC can justifiably argue that the UK resident occupier is a 'shadow director' (that is one in accordance with whose instructions the directors of the company are accustomed to act).

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

**McKie & Co Limited**
**McKie & Co (Advisory Services) LLP**
**Rudge Hill House**
**Rudge**
**Somersetshire**
**BA11 2QG**
**Tel: 01373 830956**
**Fax: 01373 830326**
**Email: enquiries@mckieandco.com**