Smith & Williamson

Tax update

A round-up of recent issues

25 September 2018

1. General

1.1 HMRC guidance on ordinary share capital released

An HMRC aide memoire has been published, providing specific guidance on the definition of 'ordinary share capital' for IT and CT.

The CIOT has released an aide memoire produced by HMRC giving detailed guidance on the definition of 'ordinary share'. The document, which had previously been for HMRC's internal use only, was discussed in a Capital Taxes Liaison Group meeting in January 2017. Public release was delayed until *McQuillan v HMRC* was final, until which time HMRC's position on the definition of ordinary share capital was unchanged. The aide memoire provides 13 examples of shares with specific characteristics and explains why these shares would or would not qualify as ordinary share capital. These examples are intended to assist in interpreting both the IT and CT Acts.

The aide memoire is published with the caveats that these are HMRC's initial views. Some of the examples, in particular, 8 and 11, are finely balanced, in HMRC's opinion, and may depend on the specific facts and circumstances. HMRC has confirmed that the Company Taxation Manual will be updated accordingly.

McQuillan v HMRC [2017] UKUT 344 (TCC)

www.tax.org.uk/policy-technical/technical-news/entrepreneurs%E2%80%99-relief-%E2%80%93-definition-ordinary-share-capital

1.2 Deadline has now passed for UK to change tax relief laws

The deadline for the UK to change the rules of two tax reliefs to bring them into line with EU law has passed. It is not yet clear if the EC will take the case to the CJEU.

As noted in our Tax Update of 14 August 2018, in the July infringement package on 19 July 2018, the EC decided to pursue legal action against Member States for failing to comply with their obligations under EU law. These decisions aim to ensure the application of EU law is applied across all Member States. The EC issued a letter of formal notice on 19 July 2018 for the UK to bring two existing tax rules in line with EU law. The rules are:

- IT relief for losses on disposals of Enterprise Investment Scheme (EIS) shares, on the basis that only shares in companies that carry out their business activities wholly or mainly in the UK can qualify for the relief (ITA 2007 s.134(5)). This puts taxpayers who invest in companies with businesses in other EU Member States at a disadvantage; and
- CT or CGT relief for irrecoverable qualifying loans is currently only available where the borrower is UK resident (TCGA 1992 s.253).

The EC warned that if the UK did not act within two months it may send a reasoned opinion to the UK authorities, which ultimately can lead to the case being brought in front of the CJEU although it is not clear how this escalation process would be affected by Brexit.

http://europa.eu/rapid/press-release_MEMO-18-4486_en.htm

2. Trust, estates and IHT

2.1 Increase in investigations into IHT returns by HMRC

Research has been released showing HMRC investigations into IHT returns increased by 5% in 2017/18, as IHT liabilities have risen with house prices.

Recent research has shown that investigations into IHT returns by HMRC have increased by 5% in 2017/18 to 5,400. The most common points of investigation were:

- the accuracy of the valuation of residential property;
- the validity of claims for business and agricultural relief; and
- the omission of assets from the estate.

The increased focus on IHT returns is in line with the overall trend of increasing IHT liabilities. Residential house prices have increased over recent years, but the thresholds for IHT have remained fixed, bringing more estates within the scope of IHT. There is also an incentive to understate house prices because this value often makes up the bulk of the total estate value.

The most recent statistics available show that 24% of IHT returns submitted in 2015/16 were investigated and the number of estates liable to IHT rose by 5% last year to 24,500.

www.thetimes.co.uk/article/new-threat-of-inheritance-tax-fines-on-thousands-of-estates-2mv6n60bd

2.2 Specialty debt – HMRC updates guidance

HMRC has published updated guidance on the IHT treatment of specialty debts, being debts created by a deed. The updated guidance considers secured and unsecured specialty debts separately, and takes a small step back from HMRC's change of approach in 2013.

Historically, the accepted common law approach was that a specialty debt was situated where the deed creating it was physically located. In January 2013, HMRC unexpectedly changed its guidance to state that this may not be the correct approach, and that many specialty debts were likely to be located in the debtor's country of residence, or where property taken as security for the debts was situated.

Following discussions with external stakeholders, HMRC has now updated its guidance on the IHT treatment of specialty debts, differentiating between secured and unsecured speciality debts, as follows:

- where the debt is solely secured on land or other tangible property situated in the UK, the situs of the debt will also be in the UK;
- where the debt is not secured, the view of the Courts is that the situs of the debt is usually where the relevant deed or instrument evidencing the debt is found. HMRC will generally adopt this approach except where there is any evidence to suggest the location of the policy documents has been artificially arranged; for example, by removing the document from the UK to avoid an IHT charge where the creditor and debtor are both resident in the UK and the debtor is non-UK domiciled.

The guidance also confirms that that this will be retrospective, stating that HMRC will take this approach regardless of when the specialty debt was created.

www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm27079

www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm27080

www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm27104

3. Business tax

3.1 Charitable company income tax claim ruled valid

The FTT has found that an enquiry cannot be made into claims for repayment of IT suffered by a company because there is no provision in the Taxes Acts for such an enquiry. It was also held that payments by parents to a charity for children's tuition were not qualifying donations because a benefit was received by the payer.

A charitable company appealed against assessments made by HMRC for overpaid IT repayments and related penalties. The charity provided tuition services to children and received payments, which it treated as qualifying gift aid donations and reclaimed the associated IT. HMRC argued that the payments were not 'donations' since a benefit was received by the payers, so the IT could not be reclaimed. The FTT also considered the validity of the assessments and penalty notices issued by HMRC in relation to the donations.

It was held that:

1. The FTT agreed with HMRC that payments made by parents of students were not donations. When, however, a volunteer chose not to bank a cheque from the charity in respect of expenses incurred on the charity's behalf, this was a qualifying charitable donation from the volunteer. Issuing a cheque to reimburse the volunteer for expenses is a diminution of the charity's resources. If that cheque is returned or not banked there is a reversal of the diminution, which amounts to a donation. The IT reclaim relating to these donations was therefore valid.
2. The enquiry itself could not have been valid since the Taxes Acts do not make provision for an enquiry into requests for repayment of IT suffered. There is an entitlement to repayment of IT that is treated as suffered; it is not a 'claim', so the provisions for enquiries into claims do not apply. The assessments arising from those enquiries were for accounting periods that did not exist and the

penalty notices were so riddled with errors that the FTT determined that an informed reader would be confused. The penalties were dismissed in full.

Champions Fun Learning Centre (a charity) v HMRC [2018] UKFTT 0516 (TC)

http://financeandtax.decisions.tribunals.gov.uk/judgmentfiles/j10653/TC06685.pdf

3.2 Commission investigation finds non-taxation of McDonald's profits is not State aid

The EC has found that Luxembourg did not give illegal State aid to a McDonald's company but the non-taxation of profits was nevertheless unfair. Luxembourg has drafted legislation to prevent similar treatment in the future.

McDonald's Europe Franchising (MEF) was tax resident in Luxembourg and had branches in both the US and Switzerland. In 2009, MEF acquired a number of McDonald's franchise rights from McDonald's Corporation in the US, which it subsequently allocated internally to its US branch. The branch then received royalties from franchisees operating McDonald's fast food outlets in Europe, Ukraine and Russia for the right to use the McDonald's brand. MEF also set up a Swiss branch responsible for the licensing of the franchise rights and through which royalty payments flowed from Luxembourg to the US branch of the company.

In 2009, the Luxembourg tax authorities granted a first tax ruling that the profits, which were from royalty payments, were not taxable in Luxembourg because they were taxable in the US under the US/Luxembourg double tax treaty. One of the conditions of the ruling was that MEF had to submit proof that its US branch was paying tax in the US. As the US branch did not qualify as a permanent establishment (PE) under US law, however, the profits of the branch were not taxable in the US. MEF argued that as the US branch qualified as a foreign PE under Luxembourg law the income should be exempt from tax in Luxembourg regardless of the US tax position. The Luxembourg tax authority agreed and issued a second ruling, removing the requirement to submit proof of tax in the US.

The EC examined the rulings and concluded that the double non-taxation did not amount to an advantage that was not available to other companies subject to similar tax rules, and hence was not State aid. In line with the OECD Base Erosion Profit Shifting project, however, the Luxembourg government has drafted new legislation to amend its tax code. Under the new provisions, conditions to be met to determine the existence of a PE under Luxembourg law would be strengthened. In addition, some companies will be required to submit confirmation that they are indeed subject to taxation in the other country.

http://europa.eu/rapid/press-release_IP-18-5831_en.htm

3.3 FTT could not help a taxpayer who claimed discrimination in the SDLT rules

The FTT has struck out an appeal by a taxpayer who had paid the 3% SDLT surcharge because of the circumstances surrounding her divorce. She claimed she was discriminated against and contacted HMRC by letter and telephone but had failed to amend her SDLT return.

The FTT found on a procedural point that it could not determine the underlying tax dispute because the taxpayer had not followed the correct procedure of amending her original SDLT return. The FTT therefore struck out the appeal, where the taxpayer claimed she was discriminated against because of circumstances outside her control. The taxpayer had paid the 3% SDLT surcharge on the purchase of a new home as, in the view of her conveyancer, she fell within the surcharge. This was because her name remained on the title of her previous home under an agreement made with her ex-husband as part of their divorce. Her former spouse and their children continued to live there. She did not receive any rent from them and had no intention of moving back to that property. Selling that home to allow the taxpayer to reclaim the additional SDLT surcharge was not a reasonable option because their daughter suffered from a severe brain injury and the house had been modified to suit her needs.

Legislation was introduced in November 2017 to provide relief where taxpayers would otherwise be liable to the surcharged rates of SDLT because they retain an interest in their previous main residence by virtue of a property adjustment order made as part of a divorce settlement. This provision was not in force, however, at the time of the transaction in question.

The Judge expressed sympathy for the taxpayer but noted that the issue at hand was neither the amount of tax paid nor the potential discrimination. The validity of the appeal depended on the taxpayer taking reasonable steps to amend her SDLT return within 12 months. Although she had contacted HMRC by letter and telephone, she had failed to amend her return regardless of HMRC writing to her to let her know that she had to take such steps to do so. It was held that the appeal should be struck out because the FTT did not have jurisdiction to hear the appeal on the tax in dispute.

Sophie Cole v HMRC [2018] UKFTT 0520 (TC)

http://financeandtax.decisions.tribunals.gov.uk/judgmentfiles/j10657/TC06690.pdf

4. VAT

4.1 FTT finds church hall construction work is zero-rated

The construction of a church hall was found to qualify for zero-rating because it was an annexe capable of functioning independently.

The FTT found for the taxpayer in a case involving the construction of a church hall, which was held to qualify as an annexe. The taxpayer had treated the construction of the hall as zero-rated on the basis that it had a use distinct from the worship carried on in the main church building. HMRC argued that the work was excluded from zero-rating because the hall was not capable of functioning independently. The FTT discussed the relevant tests and found in agreement with the taxpayer that the on the facts the church hall did qualify as an 'annexe capable of functioning independently'. The hall was intended for social activities rather than worship and was equipped as one would expect a village hall to be. Characteristics such as the separate external entrance, kitchen and bathroom facilities were considered sufficient for independent use. The construction work on the hall therefore qualified for zero-rating.

Roman Catholic Diocese of Westminster v HMRC [2018] UKFTT 0522 (TC)

http://financeandtax.decisions.tribunals.gov.uk//judgmentfiles/j10659/TC06692.pdf

4.2 HMRC launches Making tax Digital media campaign

Simplified guidance on Making Tax Digital (MTD) has been released by HMRC as it commences its media campaign to raise awareness of the new requirements.

HMRC has commenced its MTD awareness campaign by releasing simplified guidance on Twitter. The guidance does not provide any new information. HMRC has planned a wider campaign to raise awareness amidst criticism from professional bodies and businesses that the new rules have not been properly communicated. The guidance webpage explains who is required to operate MTD, how to prepare for the commencement on 1 April 2019 and what is required under the new rules.

If you would like to know more about MTD and how it will affect you or your business, please join us for our breakfast seminar on 2 October 2018. This joint event with Tax Systems will provide an overview of MTD for VAT and practical guidance on preparing for April 2019.

MTD Breakfast invitation: *http://e-comms.smithandwilliamson.com/cv/a72bc751b18949b3c7ec805eb646da29aebb0513*

MTD guidance: *www.gov.uk/government/publications/making-tax-digital-how-vat-businesses-and-other-vat-entities-can-get-ready/making-tax-digital-how-vat-businesses-and-other-vat-entities-can-get-ready*

ICAEW research: *www.icaew.com/en/about-icaew/news/press-release-archive/2018-press-releases/more-needs-to-be-done-to-make-businesses-aware-of-making-tax-digital-says-icaew*

5. And finally

Special Specialty

It was back to Wonderland this week with updated guidance from HMRC on the location, or situs, as it is known, of specialty debts (see article 2.2 above). Just pausing there, some readers may be forgiven if their knowledge of specialty, and its implications for IHT, had been less than complete. It may have come as a bit of a surprise to some that, for example, a debt can even have a location and those whereabouts may depend in law on whether or not it had a little round red sticker on it; in other words, it was created by a deed. (You don't actually even need the little sticker these days; we just pretend it's there if you meant it to be). It changes – of course, it changes - if the debt is secured, probably with little red stickers, on tangible property. If that is not all nonsense enough, the notion that this detail also matters for IHT purposes is completely absurd. As we have observed before, however, we in tax are so mad that we don't even notice.

It got even better this week. The revised guidance indicates, with a straight face, that where the supposed location has been arranged for artificial purposes, HMRC may argue that the specialty isn't actually over there, wherever that was, *but somewhere over here*. The crown of all is that the specialty may already have moved about like that for the last few years, if that is what is decided, backwards, now. It could be the Cheshire Cat.

Are these absolutely ludicrous tax fictions ripe for reform and simplification? We hope not; they help make IHT special; in fact, almost as special as VAT, which, for us, is special indeed.

Glossary				
Organisations		***Courts***	***Taxes etc***	
ATT – Association of Tax Technicians	ICAEW - The Institute of Chartered Accountants in England and Wales	CA – Court of Appeal	ATED – Annual Tax on Enveloped Dwellings	NIC – National Insurance Contribution
CIOT – Chartered Institute of Taxation	ICAS - The Institute of Chartered Accountants of Scotland	CJEU - Court of Justice of the European Union	CGT – Capital Gains Tax	PAYE – Pay As You Earn
EU – European Union	OECD - Organisation for Economic Co-operation and Development	FTT – First-tier Tribunal	CT – Corporation Tax	R&D – Research & Development
EC – European Commission	OTS – Office of Tax Simplification	HC – High Court	IHT – Inheritance Tax	SDLT – Stamp Duty Land Tax
HMRC – HM Revenue & Customs		SC – Supreme Court	IT – Income Tax	VAT – Value Added Tax
HMT – HM Treasury		UT – Upper Tribunal		

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