

Personal tax update (Lecture P1321 – 17.50 minutes)

Statutory residence test

Summary – Returning to the UK to care for an alcoholic sister and her minor children were exceptional circumstances under the statutory residence test. As a result, the appellant remained non-UK resident despite spending more than 45 days in the UK.

In this case, the First Tier Tribunal prohibited the publication of the name or address of the Appellant or any member of her family referred to in the proceedings.

The Appellant was resident in the UK, living with her husband and their two children. On 4 April 2015, she had moved with her younger daughter to Dublin and for 2015/16, declared on her Self Assessment tax return that she was non-UK resident under the Statutory Residence test. Her husband had remained in the UK in the former family home, with the intention being that in two years he would retire and move to Dublin.

On 16 September 2014 her husband transferred a shareholding to her and in the period ended 31 March 2016, she received dividends of approximately £8 million. Arguing that under the Statutory Residence Test she was still UK resident in 2015/16, HMRC sought to levy UK tax on this dividend, resulting in additional tax payable of £3.1 million.

The appellant appealed arguing that she was non-UK resident throughout 2015/16, as days spent in the UK in December 2015 and February 2016 should be disregarded under the exemption contained in Schedule 45 Finance Act 2013. She acknowledged that there was “a lot riding on the day count”.

It was common ground that in 2015/16 tax year, under the Statutory Residence Test the appellant would be non-resident in the UK if she spent 45 days or less in the UK. The Appellant accepted that by 21 November 2015, she had used up 44 days of the 45-day allowance. However, she then made two further visits, in December 2015 and February 2016, to the UK. She believed that these visits could be ignored as her presence in the UK was due to exceptional circumstances beyond her control. She claimed that in December 2015 and February 2016 she had come to the UK as her twin sister was suicidal and she needed to care for both her twin as well as her twin’s minor children.

HMRC did not accept that the appellant had shown that these exceptional circumstances had prevented her from leaving the UK on each day, since she had access to a private jet and could have returned to Dublin each evening.

Decision

There were a number of pieces of evidence that did not ring true with the First Tier Tribunal:

- If her twin was a genuine suicidal risk, it was ‘strange and implausible’ that she did not seek medical psychiatric assistance during her two visits to help her; and
- restaurant and supermarket receipts showed that she was not 100% committed to helping her sister during these two ‘exceptional’ visits;
- the Appellant had made no record, even in outline, of the reason for her visits and why they prevented her from leaving the UK.

The Appellant did not satisfy the Tribunal that she came to and remained in the UK in December 2015 and February 2016 because her twin sister had threatened to commit suicide.

Further, although medical records supported the claim that her twin had suffered with both alcoholism and depression for many years, neither were considered to be exceptional circumstances on their own.

However, the fact that the twin sister had minor children, for whom the Appellant also cared for, changed the position. The Tribunal stated:

“In our view, the combination of the need for the Appellant to care for her twin sister and, particularly, for her minor children at a time of crisis caused by the twin sister’s alcoholism does constitute exceptional circumstances for the purposes of paragraph 22(4).”

The First Tier Tribunal found in the Appellant’s favour and allowed the appeal.

A Taxpayer v HMRC (TC08464)

Redemption of preference shares

Summary - The redemption of preference shares not disclosed to HMRC made the advance statutory clearance void. The buybacks fell within the transactions in securities legislation and income tax applied.

Ivan Wroe, Stephen Rimmer and Colin Timms each owned 200 ordinary shares in Proline Engineering Limited, holding approximately 30% of the issued share capital of Proline. A fourth individual, Mr Jones, owned the balance.

In August 2013, a new holding company, Jenbest Limited, was inserted above Proline Engineering Limited. Each taxpayer exchanged their Proline shares for 25% of the ordinary share capital and £600,000 £1 preference shares in Jenbest Limited. Mr Jones was issued with 25% of the ordinary shares in Jenbest Limited.

It was argued that the reorganisation equalised the shareholdings of the four individuals while also compensating the original shareholders for the reduction in their shareholdings and facilitated their eventual retirement.

Describing the preference shares as irredeemable, the company obtained statutory clearance from HMRC that the transactions in securities legislation would not apply.

During the 2014/15 and 2015/16, Jenbest Limited repurchased the preference shares at nominal value, with the taxpayers reporting their disposal as capital gains eligible for Entrepreneurs’ Relief.

Later, HMRC issued assessments to each of the taxpayers, arguing that the transactions in securities legislation applied. The statutory clearance had been given without mention that the preference shares could and would be repurchased, making it void. HMRC believed that a main purpose to the transaction was to obtain an income tax advantage for each of the three taxpayers.

The three taxpayers appealed.

Decision

The First Tier Tribunal was referred to a letter from the company's advisers that effectively made HMRC's case for them. The letter made it clear that mentioning the plan to redeem the preference shares 'would simply flag the matter to HMRC'. If the shareholders were to reduce their combined shareholding from 90% to 75% followed by the preference share repurchase, advance clearance would be unlikely to be given. They would have successfully withdrawn £1.8 million from the company while still retaining control. The letter confirmed that in this case, the cash consideration would then be charged to income tax as a deemed dividend.

The First Tier Tribunal found that this letter made it abundantly clear that the preference shares would be repurchased but the repurchase was not needed to equalise the shareholdings. Although part of a planned retirement plan, the deal was structured to produce a capital gain, avoiding a much larger income tax charge on a deemed distribution. One of the main purposes of the buyback was to obtain a tax advantage. This was not incidental or 'merely the icing on the cake'. Key facts had been hidden from HMRC.

The First Tier Tribunal found that the advance statutory clearance was void, as the application deliberately failed to mention the repurchase of the preference shares.

The taxpayers' appeal was dismissed.

Ivan Wroe, Stephen Rimmer, Colin Timms v HMRC (TC08474)

No trading, no entrepreneurs' relief

Summary –The taxpayer's claim for entrepreneurs' relief was denied as the LLP had not started trading at the time of disposal.

John Wardle owned 14.65% of a Limited Liability Partnership (LLP) that was established in 2015 to acquire, construct, and operate a power plant in Hull using wood waste biomass.

In August 2015 the LLP entered into a number of contracts relating to the construction, operation, and financing of a plant in Hull, including a contract to purchase feedstock from a supplier.

On 14 September 2016, the LLP applied to the Environment Agency for a permit to operate the power plant, which was granted some 8 months later, in May 2017.

In November 2016, prior to the permit being granted, John Wardle disposed of just under half of his interest in the LLP. He reported the related gain in his 2016/17 tax return, claiming that he was eligible for entrepreneurs' relief.

In May 2018, HMRC opened an enquiry and in March 2020, HMRC closed their enquiry rejecting the entrepreneurs' relief claim. HMRC saw the business as a manufacturing trade and unless electricity was generated there would be no income.

John Wardle appealed arguing that the LLP's business was not simply to generate electricity. It also included the construction and operation of the plant as a waste-to-energy business, procuring waste wood and then converting it into electricity with the LLP's principal revenue stream being the sale of electricity as a by-product of processing waste wood. On that basis, the trade started in August 2015.

Decision

The First Tier Tribunal reported John Wardle had produced a limited number of documents to support his case as he:

- did not want to advertise the profitability of the business;
- claimed that certain documents were commercially sensitive and the subject of confidentiality agreements; and
- argued that supplying the details of one of the LLP's 56 contracts was sufficient evidence to provide.

To be eligible for entrepreneurs' relief on the disposal, the LLP must have been trading for at least one year prior to that disposal.

The Tribunal referred to the principles set out in *Mansell v HMRC [2006] Sp C551*, where the Special Commissioner had stated:

"I conclude that a trade cannot commence until it has been set up and that acts of setting up are not commencing or carrying on the trade. Setting up trade will include setting up a business structure to undertake the essential preliminaries, getting ready to face your customers, purchasing plant, and organising the decision making structures, the management, and the financing."

At the time of disposal, although it was claimed that a number of contractual commitments existed, construction of the plant had yet to begin. The site of the plant was a disused industrial site. It would take some two years to build after which the project would enter into a 6 to 12 month commissioning phase, where the contractor would test the plant. During that period feedstock would be burnt and electricity generated but only to test the plant. Once the commissioning process was completed the operator would take over and power generation proper would start. Further, John Wardle confirmed that the detailed design of the plant was still being worked on. The trade had not been 'set up' and was not 'operational'.

The First Tier Tribunal dismissed the appeal

John Douglas Wardle v HMRC (TC08485)

Debilitating fear of making a mistake

Summary – A debilitating fear of making a mistake, which was caused by the taxpayer's earlier experience of a criminal investigation into his tax affairs by HMRC, was not a reasonable excuse for the subsequent late filing of tax returns.

Michael Breen accepted that he had filed his 2014/15 tax return 27 months late but challenged the late filing penalties of £10,664.69 that were issued.

He argued that he had a reasonable excuse for his late filing, claiming that an earlier HMRC enquiry and criminal investigation had resulted in him having a 'debilitating fear of making a mistake' in his return'. Consequently, he did not wish to submit a return until he was confident that it was completely correct.

In October 2012 Michael Breen received a notice from HMRC entitled “Notice to Attend a Voluntary Interview Under Caution”. He was suspected of having committed a criminal offence, ‘viz the fraudulent evasion of income tax and national insurance contributions with regard to an offshore investment account with a bank in Switzerland.’ In 2013 a criminal investigation was replaced with a civil investigation. He received a Code of Practice 9 enquiry asking him to disclose the tax fraud he had committed. In February 2014 HMRC raised an assessment for the 1994/95 tax year totalling £520,000 and in February 2015 issued a further assessment for nearly £1.1million.

Decision

The First Tier Tribunal stated that mental health could constitute a reasonable excuse, provided that the taxpayer’s health had deteriorated to such an extent that they could not deal with his affairs, including preparing and submitting a tax return.

The First Tier Tribunal found that, to date, HMRC had acted in a proper manner at all times, and that Michael Breen had not produced any medical evidence to support his claim that HMRC’s behaviour had caused a ‘debilitating fear of making a mistake’ when submitting his returns.

Michael Breen did not have a reasonable excuse and the appeal was dismissed.

Michael Breen v HMRC (TC08482)