



Main Points this Month

A summary of UK tax developments during August 2005

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Tax Investigations

The Inland Revenue have issued a new Code of Practice 9 (2005) which deals with civil investigations into cases of suspected serious fraud. This will apply in respect of all such investigations commenced after 1 September 2005. The new Code of Practice has been prompted partly by the merger of the Inland Revenue and Customs & Excise into HMRC but the terms of the new code are significantly different from the old one.

In essence of course the position is the same and always will be: if the HMRC suspect you of serious tax fraud they will be all over you like a rash and assuming they have reasonable grounds for their suspicions, they will be able to obtain almost unlimited information from third parties to assist them in their enquiries. However, this is not an easy matter and they like to get as much help as they can from the taxpayer (and for him

to pay for all their investigations). They do so by the threat of swingeing penalties for lack of cooperation if they have to do all the work themselves. Accordingly, the taxpayer is encouraged to instruct a professional adviser to make a full investigation and prepare a disclosure report, disclosing all their regularities on which tax interest and penalties will be charged - and woe betide you if anything is left out.

This Code of Practice 9 does not deal with ordinary tax enquiries (they are covered by COP8) but is concerned only with cases of suspected serious fraud so a robust approach is obviously necessary on the part of HMRC. The main reason for the new code is that the Inland Revenue and the Customs and Excise had different means of conducting these investigations and they are now brought under a single code. The result is that the Hansard procedure disappears (although the questions do not) and the whole matter is dealt with as a civil

Current Rates

Indexation

Retail Price Index: July 2005	192.2
Inflation Rate:	2.9%

Indexation factor from March 1982:

: to April 1998	1.047
: to July 2005	1.419

Interest on overdue tax

Income tax/CGT/NIC	6.5%	from	06.09.05
Inheritance tax	3%	from	06.09.05
VAT	6.5%	from	06.09.05
Corporation tax	6.5%	from	06.09.05
CTSA instalments	5.25%	from	06.09.05

Repayment Supplement

Income tax/CGT/NIC	3%	from	06.09.05
Inheritance tax	3%	from	06.09.05
VAT	4%	from	06.09.05
Corporation Tax	3%	from	16.09.05
CTSA instalments	2%	from	15.08.05

Official Rate of Interest

From	06.01.02	5%
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Bank Base Rate

From	04.08.05	4.5%
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matter with no criminal overtones.

Under the new procedure, HMRC will have to decide whether to pursue a criminal investigation or to investigate under the civil procedures. Once the investigation is under way using the civil procedure, prosecution will no longer be possible - unless of course the taxpayer provides materially false information during the course of the investigation. Whether or not the removal of the underlying threat of prosecution is a good thing or not, it will certainly simplify the civil procedure as far as HMRC is concerned. It is the removal of the criminal safeguards inherent in the procedure which is the main difference between the old COP9 and the new version. One thing stays the same and that is the Hansard questions - although they will not be accompanied by the normal Hansard statement about the Board reserving a discretion to pursue prosecution. Otherwise the five Hansard questions are repeated in the new Code as questions which will be asked at the outset of an investigation; slightly different questions will be asked in connection with a VAT investigation.

There are some curious differences between the old and the new practice. HMRC continue to emphasise in many different places that the taxpayer has free choice whether or not to attend a meeting and whether or not to cooperate with the Inland Revenue's enquiries. This is not a conclusion one generally divines from the

conduct of Inland Revenue investigators but it is nice to have it so clearly stated. They also start the Code of Practice with a clear statement:

"We will keep an open mind to the possibility that there may be an innocent explanation for the suspected irregularities".

Of course they must do so - but by the time they have considered whether to prosecute, and have decided that a civil investigation into suspected serious fraud is necessary, they must surely be beyond the point of keeping an open mind about innocent explanations.

It is interesting to see that the new Code of Practice repeats the undertaking to treat the taxpayer fairly and courteously - although they do not repeat the undertaking in the previous code that they will "only ask for information we believe to be necessary". I wonder why not.

More importantly perhaps HMRC would say that they would only have commenced the investigation because they had grounds to suspect that there are irregularities in your tax affairs. However, for reasons which cannot be discerned despite professional representations, they go on to say that they will not reveal what those grounds are.

This will be particularly irritating to the innocent victim who is not aware of any irregularity in his

tax affairs. He will be pleased to see that:

"You have the right to ask us why we are continuing with our investigation if for example you believe that you have provided all the relevant information and explanations"

but will go completely bonkers when he reads a little further to find that he can ask as much as he likes - but they won't tell you. (I cannot imagine why such a passage is included in this statement and it can serve no possible purpose - and particularly as it conflicts with the contents of the previous code).

The new practice enables an investigation of direct and indirect tax matters to be undertaken jointly although it would seem that this is unlikely because each tax will have to be covered separately using the powers appropriate to that tax and so that it is clear to the taxpayer which tax is being dealt with at all times. However, the possibility of doing these things jointly clearly has a simplicity about it consistent with the new merged body.

Domicile

Domicile cases are becoming ever more frequent. The latest Special Commissioners decision, *Allen & Hatley (Johnson's Executors) v HMRC SpC 481* concerned the question of whether Mrs Johnson who lived in the UK for several years up to the date of her death had lost her domicile of choice in Spain, thereby becoming liable to UK inheritance tax on the whole of her worldwide assets.

In many ways this case is unexceptional and (as always) was crucially dependent on the facts. However, it did have some interesting features.

Mrs Johnson had a domicile of origin in England and in 1982 she acquired a domicile of choice in Spain. Following the death of her husband in 1996, Mrs Johnson stayed with some relatives in England. She was suffering from Parkinson's disease and although not in need of constant care, she welcomed the support provided by her relatives. The plan was that she would stay

temporarily and return to Spain. She returned to Spain whenever she could (although she was not able to go on her own) but she always regarded Spain as her home and only as a visitor at her relatives' house. She died in 2002 and HMRC claimed that she had abandoned her domicile in Spain and died domiciled in the UK. It is relevant to note that as Mrs Johnson had acquired a domicile of choice in Spain the onus was on HMRC to prove on the balance of probabilities that she had abandoned that domicile.

The tests for the loss of a domicile of choice are quite clear and derive from *Dacey & Morris*; Rule 13, which reads as follows:

"A person abandons a domicile of choice in a country by ceasing to reside there and by ceasing to intend to reside there permanently or indefinitely, and not otherwise".

Accordingly, there were two questions to be answered: had Mrs Johnson ceased to reside in Spain, and if so, had she ceased to intend to reside there permanently or indefinitely.

Throughout the period until her death Mrs Johnson retained her house in Spain and kept it maintained in a state ready for immediate and comfortable occupation. Even her pets were maintained there. There was no use of the house other than on the visits which she made with her relations. On these grounds the Special Commissioner concluded that she clearly had a place of residence in Spain until her death. During the periods that she visited the house she was residing in Spain for the purposes of the law of domicile. However, the more difficult question was to determine whether she was residing there after those visits ceased.

Residence for this purpose is considered to be physical presence in the country as an inhabitant and the Special Commissioner concluded that once Mrs Johnson's visits ceased, she no longer had any physical presence in Spain and therefore ceased to reside there, notwithstanding that she retained her house which was available to her as a resident.

Accordingly, it became necessary to consider the second question which was whether Mrs Johnson

had ceased to intend to reside in Spain permanently or indefinitely. Whilst in the UK, Mrs Johnson did not attempt to gather around her any of the effects from her home - she considered herself to be a visitor and preserved her home in Spain clearly indicating an intention to return as soon as she could.

HMRC suggested that the state of Mrs Johnson's health meant that her intention the return had simply withered away in the face of the inevitable lack of physical capacity. A good point perhaps but the Special Commissioner did not consider the evidence was sufficiently strong to merit that conclusion and that until her death she continued to cherish the realistic hope that she would be able to return to Spain. Accordingly, Mrs Johnson did not lose her Spanish domicile of choice (but it could so easily have gone the other way).

This case contained a teasing reference to the decision in *Plummer v IRC* [1987] STC 698 which has long been a source of controversy. In *Plummer*, it was suggested that Rule 13 of Dicey needs to be qualified where a taxpayer retains a place of residence in their domicile of origin and also in their domicile of choice.

“Rule 13 if read literally appears to go too far ... these words might suggest that a domicile of choice (and presumably a fortiori a domicile of origin) cannot be lost until the person in question has ceased altogether to reside there. I do not think that the rule was framed with dual residence in mind... a loss of a domicile of origin or choice is not inconsistent with the retention of a place of residence in that country if the chief residence has been established elsewhere”.

It is generally considered that this passage is confused and does not qualify Rule 13 at all. *Plummer* was concerned with the acquisition of a domicile of choice and the loss of a domicile of origin which is governed by Rule 10 and not Rule 13 which deals with the loss of a domicile of choice. The comments made in *Plummer* about the loss of a domicile of choice and domicile of origin are all mixed up.

Whilst it might be possible to say that the acquisition of a domicile of choice can be determined by reference to the chief residence

where there are a number of competing territories, it seems impossible to apply such reasoning to the loss of a domicile of choice in total disregard of the express terms of Rule 13.

Not unnaturally, the Inland Revenue suggested that because of *Plummer*, Mrs Johnson should be regarded as resident in the UK because her chief residence was here rather than in Spain. Unfortunately the Special Commissioner made no further comment on this point. We shall have to wait for another case to resolve the confusion and uncertainty caused by *Plummer*.

Stamp Duty

HMRC have announced a change in their practice regarding the reorganisation relief from stamp duty.

Where a company acquires the whole or part of the undertaking (or the shares) of another company the transaction will qualify for stamp duty exemption if it satisfies the conditions in section 75 to 77 Finance Act 1986. One of the conditions for this relief was that the registered office of the company is in the UK. However HMRC have now accepted that this is not a condition which can be imposed any longer; the relief will be given where the registered office of the acquiring company is in any EU state. This is of course subject to all the other conditions being satisfied, not least that the transaction must be undertaken for bona fide commercial reasons and not form part of a scheme for the avoidance of tax or stamp duty.

Companies that have paid stamp duty on the basis that these reliefs only apply to acquiring companies with registered offices in the UK are able to claim a repayment of that duty in respect of instruments executed after 22 July 2003.

Work In Progress

The infamous UITF abstract 40 which deals with the recognition of revenue of professional firms is continuing to cause anxiety. It may be

remembered that this new accounting practice requires professional firms to include in their accounts a greater proportion of the value of uncompleted work, contrary to the long established practice of excluding partner time in the work in progress valuation. The Institute of Chartered Accountants say that the change in the basis of accounting will produce an uplift to the taxable profits in the year of change without generating any additional cash to pay the tax. For some businesses this could cause a real crisis, adversely affecting their competitive position and ability to survive. The Institute has written to the Chancellor of the Exchequer in an attempt to obtain spreading relief in respect of the additional tax which arises by reason of the adoption of this accounting practice.

Apparently the Government is prepared to consider some kind of spreading relief and the Institute is therefore seeking information from professional firms about the effect this change is likely to have on their practices. Such information would provide evidence for the Institute to continue their lobbying with the Government.

Excuse me, but this seems to be a problem entirely of their own creation. It is not the Government that introduced UITF Abstract 40 but the Institute itself - and there is considerable difference of opinion on its soundness - and more particularly on the tax implications. It seems a bit much for the Institute to come up with a new accounting practice and then complain that it gives rise to a tax problem for which they seek relief. Professional firms have been preparing accounts on a basis fully accepted as correct for decades. Why are they suddenly all wrong?

If it is right that UITF Abstract 40 is the shining truth to which we have hitherto been blind, then fair enough. However, if it is just a fashionable new idea I would suggest that the implications might have been thought through a bit more first - rather than having to go to the Chancellor for a bandage after shooting themselves in the foot.

Clearly some hardship will arise (although there is considerable doubt whether the effect of the abstract will be as significant as is sometimes claimed) but I honestly wonder why the HMRC

are bothering about it at all.

Performing In The UK

The Foreign Entertainers Unit have published guidance explaining how foreign artists' service companies can make an application for a reduction in their tax payments in respect of their employees performances in the UK. They will require a copy of the engagement contract between the non resident company and the UK promoter a statement of the employment status of each of the performers, their nationality and residence, and details of all expenses paid in relation to the UK engagement. They also require a copy of any separate agreement or contract between the non resident company and any conductor soloist and anyone else who makes a public appearance on stage but they do not require such details in respect of the management, technical or backstage staff.

It will be interesting to see whether any revised guidance becomes necessary (or is issued) when the appeal in connection with Andre Agassi is heard by the House of Lords.

Trust Taxation

It may be remembered that the Finance Act 2005 introduced a relief for trusts whereby the first £500 of income that would otherwise be taxable at the special trust rates of 40% (or 32.5% for dividends) 500 will be taxed at the basic rate 22% or the lower rate or the dividend ordinary rate of 10% depending upon the nature of the income. I cannot imagine the amount of public money has been spent in providing this a miniscule amount of relief.

It gets worse. The latest HMRC Bulletin contains nearly 5 pages of explanation about how this £500 band works. Any tax saving which might possibly accrue to the client will be completely eroded by the cost of simply reading the Inland Revenue's explanations; why do they do it.

I am not sure I can be bothered with this at all, but in case anybody is interested, the £500 band

applies to the lowest slice of income and is set first against income chargeable at the basic rate. Any amount remaining is then applied to income chargeable at the lower rate, finally any amount remaining is still applied to income chargeable at the dividend ordinary rate.

Taxpayers Costs

The ability for costs to be awarded by the Special Commissioners is very restricted indeed. In general terms the Special Commissioners may award costs against any party if they have acted wholly unreasonably in connection with the hearing. This is a very difficult test to satisfy and the professional standards of the Inland Revenue are such that they are unlikely ever to act wholly unreasonably in connection with an appeal hearing. My confidence was dented a little by the recent case of *Carvill v Frost* to which reference has been made in earlier tax bulletins, but again that could reasonably be regarded as an aberration which the Inland Revenue would be keen not to repeat.

The more recent case of *Hayley McEwan SpC 488* gives the issue a bit of a tweak. The Inspector of Taxes had taken the view that Miss McEwan's business takings were understated because there were certain unidentified credits to her building society account. He sought an addition to sales to reflect these figures. However, despite the provision of information demonstrating that the unexplained deposits were not business income, the Inspector continued to insist on an addition to the profits.

Although costs were not awarded for other reasons, the Special Commissioner did say that this action was wholly unreasonable and it may be the ability to obtain costs before the Special Commissioners may be getting slightly easier.

This is not all good news of course because costs can be awarded both ways.

Transfer Pricing

The Finance (No 2) Act 2005 made a number of changes to the transfer pricing rules and the rules relating to certain loan relationships. HMRC has issued some helpful guidance concerning the transition provisions and the meaning of "acting together" for the purpose of transfer pricing.

They particularly highlight the position where a bank lends money to fund the acquisition of a company, possibly in connection with a management buyout. The deal may involve the future shareholders and the bank having a common interest in both sides of the transactions through the provision of equity warrants. This will not be regarded as a non arm's length transaction because these should not be significant factors affecting the bank's lending decision.

The same conclusion may not arise with private equity investments because the coordination of the lending with both the acquisition of the shares and lending by other entities will involve a change in the balance of risk in relation to the lending when the loans are proportionate to shareholdings.

HMRC do not consider it is necessary for there to be any discussion or direct agreement between persons for them to be acting together. A company may make separate loan agreements with the issue of shares to a number of shareholders who will be acting together for this purpose. They take the view that this applies to any circumstances which enables transactions to be made other than on an arm's length basis. Isolated parties acting entirely independently would generally make transactions on an arm's length basis - but if the owners of a company coordinate the transactions, possibly involving third parties such as lenders, they would be acting together and the result of the transaction may differ from an arm's length result, bringing the transfer pricing legislation into play.

HMRC consider that the coordination for linking of transactions, where the same persons have an interest in both sides of the transaction, or third parties are involved, may all be reasons why the transaction would not give rise to an arm's length

result and the legislation would apply.

Full details of the Inland Revenue's guidance is available on request.

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