



private clients

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1 UK tax residence (continued

Leaving the UK for the purposes of becoming non-resident

As we reported in our Summer Update last year, H M Revenue & Customs (HMRC) have over the last few years been taking a much more aggressive approach to questions of residence and have been experiencing considerable success in persuading the courts that their current approach is correct in law.

Attention was particularly focused on the case of Mr Gaines-Cooper, which has been widely reported. Mr Gaines-Cooper purported to leave the UK in the 1970s, and in order to secure (he thought) his position as not resident in the UK he ordered his affairs in accordance with his interpretation of the guidance on these issues given by the Inland Revenue (as they were then) in their published booklet IR20. Both the Special Commissioners and the High Court found that Mr Gaines-Cooper had in fact remained resident in the UK under UK law.

An essential part of these decisions was that the guidance given in IR20 had no statutory force, and in practice only applied any way in certain limited circumstances. Although with hindsight it is possible to read certain disclaimers that were included in IR20 as having this effect, this was not the widely understood interpretation of IR20 for most of the twenty odd years it existed as HMRC's published guidance.

Mr Gaines-Cooper therefore applied for judicial review of the decision to find him resident in the UK, on the basis that IR20 had given him the legitimate expectation that he should not be so resident in the UK, and it was therefore inequitable for him to be found to be so resident. His application has been dismissed by the Court of Appeal. It was found that the interpretation of IR20 that HMRC had pursued was supported by the wording of the guidance, and in effect that Mr Gaines-Cooper had misunderstood the guidance rather than HMRC having derogated from it.

Whilst perhaps not unexpected, this continues to leave individuals who either wish to become not resident in the UK (thought to be an

increasing number presently), or who in fact believe that they have ceased to be resident in an earlier tax year, in a difficult and uncertain position. Such individuals' residence position now turns to a large extent on a subjective assessment of the nature of their continuing ties to the UK, and whether they have made a "distinct break" with the UK. In at least one high profile case this has led to an individual who wished to break residence in the UK refusing to set foot in the UK after the time of his departure.

One ray of light that did emerge came from the case of Mr Davies, which was held jointly with the Gaines-Cooper application. In that case it was confirmed by the Court of Appeal that HMRC should be bound by the guidance they have given where this is clear and unambiguous. This was given in the context of the guidance found in IR20 on individuals who leave the UK for the purposes of full-time employment abroad where the employment lasts for longer than one complete tax year. Such individuals are treated as not resident during the complete tax year they are absent, regardless of any continuing ties to the UK, as long as their visits to the UK are less than 183 days per year and average less than 90 days per year on a four-year average. This decision also made clear, however, that the terms of this guidance do need to be strictly followed, and that the individual must leave the UK to take up the employment, and it must be a genuine full-time employment.

Ordinary residence and coming to the UK

HMRC have also been taking a more aggressive approach to individuals who come to the UK, especially for a limited time, usually for a period of employment. Such individuals are resident in the UK from the day that they arrive but they may not be "ordinarily" resident. If the individual is not ordinarily resident then he is subject to tax on the remittance basis on his employment income to the extent that the duties of his employment are carried on outside the UK.

IR20 set out circumstances in which an individual would not be considered as ordinarily resident in the UK. Broadly, the conditions were that the individual arrived in the UK intending to be resident for fewer than three

years, and did not purchase a property in the UK during the period of residence. If, despite the individual's intention, he did in fact remain in the UK for more than three years then IR20 stated that he would be treated as ordinarily resident from the start of the tax year following the third anniversary of his arrival.

It was found in the case of Mr Genovese that the guidance in IR20 was in fact wrong in law, and that an individual becomes ordinarily resident from the start of the tax year in which the third anniversary of his arrival falls, ie one year earlier than set out in IR20.

However, following the decision in Davies discussed above, there would appear to be a good case to argue that HMRC will be bound by the terms of the old IR20 for any period in which that was the unambiguous guidance issued by them, and this may provide some comfort in respect of earlier years.

The current guidance issued by HMRC from 6 April 2009, which is known as HMRC6, reflects this shorter time period.

However, a further case, that of Mr Tuczka, has thrown even this shorter period for ordinary residence into doubt. Mr Tuczka, who came to the UK for the purposes of a short-term employment intended to last only two and a half years, was found by the First Tier Tribunal to be ordinarily resident in effect from very soon after the day he arrived. Mr Tuczka originally appealed against a ruling by HMRC that he had become ordinarily resident by virtue of purchasing a property in the UK. The tribunal agreed with Mr Tuczka's submission that there was no basis in law for the purchase of a property to be such an important deciding factor in determining the ordinary residence position of an individual. However, they came to the conclusion that where an individual comes to the UK for a settled purpose such as an employment then they will become ordinarily resident very shortly after they arrive in the UK. If this judgement is not successfully appealed, it could have far-reaching consequences for the tax treatment of employees seconded to the UK, making the UK a far less attractive destination for employees on short-term assignments in the UK.

2 Last chance Liechtenstein

HMRC has over the last few years introduced reasonable tax ‘amnesties’ with favourable terms, to give non-compliant UK taxpayers the opportunity voluntarily to disclose unpaid UK tax on foreign income and gains sheltered in offshore accounts. The 2007 Offshore Disclosure Facility (ODF) is estimated to have yielded around £440 million in tax revenues which would have otherwise remained buried in that gap. The more recent New Disclosure Opportunity (NDO) in July 2009, advertised as the last chance for taxpayers to disclose any irregularities in their affairs, is estimated to have raised a further £500 million.

Giving non-compliant UK taxpayers every opportunity to make good, just two weeks after the NDO HMRC announced a further ‘last opportunity of its kind’, the Liechtenstein Disclosure Facility (LDF). The projected revenue for HMRC this time is £1 billion. Launched on 1 September 2009 and running until March 2015, the LDF is a means for UK taxpayers with an undeclared tax liability in relation to offshore assets or income-sources to make full disclosure to HMRC and ‘enjoy’ perhaps the most favourable (as well as unprejudicial) treatment offered to date.

The LDF is open to all UK taxpayers, including corporate entities and trustees as well as individuals, who hold assets or interests in Liechtenstein and who have undeclared UK tax liabilities. (Non-UK domiciliaries taxable on the remittance basis who have unremitted foreign income or gains are not concerned). UK taxpayers who hold a foreign bank account in their name which was opened by a UK branch or agency are also eligible to use the LDF for disclosure, but they cannot benefit from the preferential terms.

The key benefits of making a voluntary disclosure under the LDF are as follows:

- A flat penalty of just 10% of the unpaid tax.
- Only tax liabilities arising in the last 10 years, since April 1999, need to be disclosed.
- Taxpayers can choose to pay the outstanding tax at their actual rate of liability

for each tax year, or elect to apply a single ‘composite rate’ of 40% to all tax years concerned. The composite rate is particularly beneficial in the example of undeclared profits arising to an offshore company and then distributed to an individual taxpayer by way of dividend. This type of transaction might well be subject to a double tax charge in excess of 40% if the composite rate were not applied.

- Where tax liabilities are undeclared as a result of ‘innocent error’, a reduced penalty of 0% will apply and disclosure of liabilities is required for only the last six years. It is likely that the criteria to qualify for treatment as an ‘innocent error’ will be very narrow.

HMRC does, however, reserve the right to disapply the preferential terms in certain circumstances where disclosure is not made fully voluntarily or in full honesty. For example, where taxpayers using the LDF have been contacted by HMRC before they have made a voluntary disclosure a higher penalty (maximum 20%) will apply. Similarly, a ‘significantly’ higher penalty (no figures have been provided officially) will apply where a taxpayer has been under HMRC investigation for serious tax fraud or arrested for a criminal tax offence and has knowingly failed to declare unpaid tax liabilities, or if a taxpayer was already under such an HMRC investigation on 11 August 2009.

In order to encourage UK taxpayers to disclose under the LDF, HMRC has promised not to ‘name and shame’ those using the LDF nor automatically make their tax affairs the subject of increased scrutiny in the future. There is also a golden guarantee that LDF users will not be subject to criminal prosecution so long as the source of the funds is not derived from criminal property, as defined in the Proceeds of Crime Act 2002 (other than tax evasion).

But perhaps the most beneficial feature of the LDF is that UK taxpayers with undeclared funds offshore who do not currently have assets or an interest in Liechtenstein can become eligible to use the LDF and take advantage of its favourable terms by establishing a link with the country now. To do so, taxpayers must establish a relationship with a financial intermediary in Liechtenstein. By establishing this link, such taxpayers can then

disclose all undeclared tax liabilities from worldwide sources, not just those they have transferred to Liechtenstein, and benefit from the LDF's favourable terms for all sources.

For UK taxpayers the terms of the LDF are certainly more favourable than the penalties and terms offered by the forerunning NDO, and a voluntary disclosure under the LDF brings far more preferential treatment than if an undeclared UK tax liability is discovered by HMRC by means of a serious tax investigation. There is even a real threat that if HMRC does not obtain details of undeclared UK tax liabilities by its own methods, HMRC may be alerted to a taxpayer's undisclosed income or gains by an obliging third party. Earlier this year a bank in Switzerland admitted that the theft of client data by a former employee contained the details of 24,000 client records, stolen with a view to selling the data to interested governments. Recently, too, Switzerland has adopted a provision of full mutual assistance under its Tax Treaty with the UK, subject to ratification.

There is therefore an element of pressure and urgency for currently non-compliant UK taxpayers to take advantage of the preferential terms of the LDF by making a voluntary disclosure to HMRC before their undeclared tax liabilities are discovered by external means. And with the Chancellor Alistair Darling observing in the 2010 Budget that the UK government is in pursuit of ever more countries with which to sign targeted TIEAs, time to take advantage of the LDF's attractive terms may be running out.

3 Anti-Avoidance - the retrospective approach

*“..... the question is whether we’re going forward to tomorrow or whether we’re going to go past to the back We don’t want to go back to tomorrow, we want to go forward.”
Dan Quayle*

A fundamental principle for any government that claims adherence to the rule of law is that new legislation should not apply with retrospective effect to change the legal consequences of events that have occurred in the past. Derogations from this principle are rare in modern democracies and should only be justified by exceptional circumstances – examples include legislation introduced to enable the prosecution of past war crimes..

In recent years the Government has made use of retrospective legislation to attack past tax avoidance which, it appears, would have succeeded under the law in force at the time the planning was implemented. A recent High Court case (*Huitson v HM Revenue & Customs*) suggests there is judicial support for this approach.

In 2008, the Government introduced legislation to counter planning arrangements which would have protected UK trading income from tax. The arrangements involved an individual conducting a UK trade through the intermediary of an Isle of Man partnership. Although there were UK anti-avoidance provisions in place to attribute the income to the individual and ensure he would be taxed on it, the planning was founded on the premise that the UK/Isle of Man double tax treaty would effectively frustrate the operation of those provisions. The 2008 legislation (introduced subsequent to the planning undertaken by Mr Huitson) asserted the primacy of the anti-avoidance measures over the double tax treaty, not just from 2008 onwards but also for earlier years.

The High Court dismissed Mr Huitson’s claim that retrospective legislation on this basis is contrary to the European Convention on Human Rights. The judge found that the ECHR did not impose an absolute prohibition on retrospective legislation and that it could be introduced where thought proportionate to the

potential risk to Government finances.

We have come a long way from the judicial stance adopted in the 1920’s which supported an individual’s right to legally arrange his affairs in a manner that minimised his potential liability to tax. HMRC have shown a willingness to cross national boundaries in demanding information from foreign banks on UK individuals. It now appears that temporal boundaries are no obstacle to their pursuit of taxes. On the other hand, professional advisers can incur substantial penalties if they fail to make advance disclosure of certain tax avoidance arrangements that have not yet been implemented. Similarly, those who have thought that their past planning was effective under the law as it then stood can no longer feel reassured that future legislation will not deem the rules to have said something entirely different to what was actually printed in the statute book at the time.

Advisers and clients will now need to bear in mind the possibility that any contemplated planning may be rendered ineffective by new laws introduced with retrospective effect. One may hope that this practice will be limited to the more “aggressive” forms of tax avoidance strategy. However in many areas of tax law affecting the private client, HMRC have of late started to label as “unacceptable” or “artificial” areas of tax planning which advisers have traditionally thought to be uncontroversial.

4 It could be you HMRC's High Net Worth Unit

HMRC established the High Net Worth Unit (HNWU) in April 2009. Their aim was to create a team to deal with their wealthiest "customers". The team would deal with both UK domiciled individuals and non-domiciled individuals.

In May 2009, HMRC started to identify those taxpayers who would be looked after by the team. Letters were sent out to those taxpayers (and their agents) initially selected for the HNWU. HMRC regularly review the list of taxpayers looked after by HNWU and refine the list accordingly. If selected, clients receive a letter from HMRC advising that their affairs are to be dealt with by the HNWU at Stockton-on-Tees.

Why create a specialist HNWU?

HMRC have limited resources and apply a risk based approach when deciding how to deploy their staff. They target their resources where they imagine they will get the greatest return. This echoes the more general public perception that the wealthy pay low effective tax rates and are able to avoid tax through careful planning. By HMRC being seen to target these individuals it will do no harm to their reputation.

What can you expect if your affairs are dealt with by the HNWU?

The HNWU is staffed by individuals who previously worked in the Complex Personal Return Teams. These are some of the most competent and technically proficient HMRC staff.

Officers are allocated a smaller number of taxpayers than in other HMRC offices. As a result, they are expected to have a better understanding of their affairs. HMRC are aiming to take a holistic approach so the individuals will be looking at all aspects of a taxpayer's affairs. HMRC hope that this will ensure they are better able to understand the taxpayer's affairs and therefore ensure they are paying the correct amount of tax. They also hope to deal with issues more quickly possibly even in real-time.

The HNWU is modelled on the Large Business Service. The Large Business Service unit at HMRC deals with the country's largest corporate taxpayers such as multi-nationals and investment banks. Companies dealt with by the Large Business Service are allocated a Client Relationship Manager who oversees HMRC's relationship with the company and will work alongside colleagues in HMRC's Direct Tax, VAT, PAYE teams etc who deal with specific aspects of the company's tax affairs. The Client Relationship Manager will look to obtain a good understanding of the company's activities, carry out risk-reviews with the company's tax department/advisers and agree action plans for dealing with issues. The company's tax department has the benefit of being able to liaise with someone who has a good understanding of the business and they can then obtain advance agreements on some issues.

Large companies and wealthy individuals are quite different. For one, an individual may have a number of tax advisers dealing with his affairs rather than one point of contact. In addition, HMRC will need to realise that individuals are private people and may not welcome more active HMRC contact. The HNWU is still quite new and so we will have to wait and see how it operates in practice.

Not selected for HNWU, you could be selected by the Charity Assets and Residence tax office

We have noticed that a large number of those clients who claimed the remittance basis on their 2009 UK tax returns have received notifications from HMRC advising them that their tax affairs are to be dealt with by Charity Assets and Residence tax office in Liverpool. In some cases, clients have had their affairs reallocated from the HNWU to this office. HMRC would appear to be creating a specialist team to deal with the affairs of remittance basis users.

In February 2008, Dave Hartnett (then Acting Chairman of HMRC) issued a letter which set out the Government's intentions at the time for the remittance basis. One comment generally assumed to be helpful was that remittance basis users would not be required to "make any additional disclosures about their

income and gains arising abroad. So long as they declare their remittances to the UK and pay UK tax on them, they will not be required to disclose information on the sources of the remittances". This letter was intended to reassure foreign domiciled taxpayers and their advisers following publication of draft legislation which was widely regarded as draconian. There is now a degree of apprehension that forming a specialist office to handle the affairs of remittance basis users may be a prelude to an increased volume of enquiries. Time will tell.

What to do next...

If you are interested in any of these issues and wish to discuss them in more detail, please call the Rawlinson & Hunter partner who normally acts for you. If you are not one of our regular clients but would like more information or advice, a full list of partners is provided on this page and any of them will be delighted to help you.

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