

# PRACTICE UPDATE

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## IN THIS ISSUE:

1. **Cause for Concern?** – Extensions of HMRC's powers are due to be introduced on 1 April 2009.
2. **Interest on Joint Loans** – When is 100% tax relief available for interest paid on husband and wife loans?
3. **Entrepreneurs' Relief** – Why it is important to know what type of trust you are dealing with.
4. **'Disappearing' Concessions** – Why many ESCs are being withdrawn, and what is happening to them.

## HOLIDAY OFFICE CLOSURES

The office will close for Christmas and New Year on Tuesday 23 December 2008, and will reopen on Friday 2 January 2009. **SEASONS GREETINGS & BEST WISHES FOR 2009!**

### 1. Cause for Concern?

DESPITE MANY TAXPAYERS (and some agents!) considering that HMRC already have enough powers, new powers were introduced in Finance Act 2008, which are scheduled to take effect from 1 April 2009 (FA 2008, Sch 36).

The new powers allow HMRC officers to issue notices to provide information or produce documents "for the purpose of checking the taxpayer's tax position". This includes the introduction of rules allowing HMRC officers to inspect business premises.

A 'check' for these purposes could be anything from a short telephone call to a detailed investigation into a person's financial affairs over a number of years. 'Tax position' includes past, present and future liabilities.

#### End of the enquiry window?

These new rules mean that HMRC's information powers are no longer related to enquiry notices. In some cases, HMRC officers will be able to inspect records **before** the relevant tax return is filed. Some tax commentators have observed that this change signals the end of the tax return enquiry 'window' as we know it.

Taxpayer notices can also be issued if a tax return (i.e. personal or company) has

already been made, if a self-assessment enquiry is in progress in respect of that return, or if an HMRC officer has reason to suspect a loss of tax, or if it relates to VAT or PAYE.

Information notices do not require privileged information to be provided to HMRC. However, legal and professional privilege does not apply to auditors and tax advisers. The new powers do provide some protection (as does the current legislation), but it is broadly limited to information related to audits, or to tax advice, and to documents created and belonging to them. There are exceptions to this protection, including explanatory information provided to the client by his accountant in relation to a document already supplied to HMRC.

#### Information and inspection notices

It is important to appreciate that information and inspection powers can only be used in certain circumstances. Normally, the individual's or company's self-assessment return (or claim) will be under enquiry for the relevant period.

However, there are exceptions to this general rule, such as where a person is not required to submit a tax return, or for VAT or PAYE purposes (i.e. where there is no enquiry process). In addition, HMRC can give information notices if they discover or have reason to suspect that

tax has not been assessed, or that tax has been understated, or that excessive tax relief has been given.

HMRC's powers extend to copying or removing documents. Whilst there is a right of appeal against information notices, this right does not extend to information or documents forming part of the taxpayer's 'statutory records', or to an information notice issued by the First-tier Tribunal.

### Inspecting business premises

Perhaps the most controversial feature of the new powers is that an HMRC officer can enter a business premises and inspect the premises, business assets and documents, if the inspection is reasonably required to check a person's tax position. However, this power does not allow HMRC to force entry, or to conduct a search. Nor can HMRC inspect any part of a premises used solely as a dwelling.

HMRC will normally try to agree a time for the inspection, or otherwise give at least 7 days' notice of a premises visit, which must be at a 'reasonable time'. However, inspections may be unannounced in certain cases (i.e. if made by an authorised officer, or with the approval of an authorised officer or the new First-tier Tribunal').

There is no right of appeal against an inspection. However, there is an appeal procedure in respect of a failure to comply. Penalties can only be imposed if the inspection has been authorised by the First-tier Tribunal. The standard penalty for obstructing an HMRC officer in an inspection, or for failing to comply with an information notice, is £300. Thereafter a possible maximum penalty of £60 may be imposed for each day that the obstruction or failure continues. There is a general right of appeal against both penalties. Tax-related penalties can also apply in some cases.

### Limitations of powers

Whilst HMRC's information powers may

seem ominous, there are certain limitations. For example:

- Clients may refuse an HMRC officer entry to their business premises (although if the inspection has been approved by the First-tier Tribunal, a penalty can be imposed);
- HMRC officers are not entitled to force entry to a business premises, or search the premises.

HMRC's information and inspection powers are intended to be used on the basis of risk. However, it will be interesting to see the extent to which 'tax positions' are checked at random, and whether the taxpayer will be informed if the check is random or not.

### Protecting clients

Some comments in the tax press suggest that concerns about HMRC's new powers have been largely exaggerated by many practitioners. However, the changes cannot be ignored or underestimated. Steps that advisers should consider to protect their clients include:

- Making full and proper disclosures in tax returns;
- 'Training' clients to keep and maintain good records;
- Knowing and understand the law relating to HMRC's powers, and particularly their limitations;
- Instructing clients to communicate any direct contact made by HMRC; and
- Ensuring that transactions are implemented properly, and that supporting documentation is complete and correct.

Please do not hesitate to contact me if you have any particular issues or concerns about HMRC's new powers.

## 2. Interest on Joint Loans

IT IS NOT UNCOMMON for married couples (or civil partners) to take out a joint loan, where only one of them (say,

the husband) applies the proceeds for a purpose that qualifies the loan interest for tax relief. What is the tax position if the interest on the joint loan is paid out of a joint bank account? Can the husband claim relief for all the interest paid in this example, or only half?

The good news is that in HMRC's view if husband and wife take out a joint loan, but only one of them uses the loan in a manner that qualifies for tax relief, that spouse is entitled to full tax relief on the loan interest paid, even if the joint liability is settled out of a joint account. This point is confirmed in HMRC's Savings and Investment Manual at paragraph 10030.

For example, husband and wife take out a joint loan for £250,000. Husband uses that loan to purchase shares in a qualifying company. Loan interest in the tax year amounted to £25,000, which was paid from a joint bank account. HMRC accept that Husband would be able to claim tax relief on the full amount of interest paid of £25,000.

However, what if one spouse (say, the wife) had taken out the loan, but husband and wife had both used the proceeds to purchase shares in the qualifying company? HMRC would not allow loan interest relief on the husband's share purchase in those circumstances. This is on the basis that the loan has not been used by the person to whom the loan is made. Some care is therefore needed when advising clients on taking out qualifying loans such as to acquire an interest in a close company or a partnership, to ensure that the loan interest qualifies for full tax relief.

### **Now you see It...**

An interesting point arose in preparing this article, concerning HMRC's guidance manuals. Their view regarding interest paid on joint loans was originally in the Relief Instructions Manual at paragraph 420. Unfortunately, RE420 no longer exists! It was removed on 3 September

2008. This initially caused me some alarm; had HMRC changed their view on interest relief in the above circumstances? Fortunately, upon further investigation the deleted material was found in the Savings and Investment Manual instead.

This episode demonstrates the importance of checking HMRC's manuals for updates on a regular basis. In addition, if relying on guidance in HMRC's manuals, it would be good practice to print a copy of the manual extract, showing the date on which the guidance was accessed and printed.

## **3. Entrepreneurs' Relief**

TAXPAYERS AND ADVISERS will now be becoming familiar with entrepreneurs' relief (ER), which has been with us since 6 April 2008, particularly as it affects individuals. However, what is the ER position regarding trusts and estates?

The position regarding the personal representatives of a deceased individual is that no ER appears to be available. There is no facility for personal representatives to claim ER on behalf of the deceased, irrespective of whether he or she had satisfied the ER conditions up to the date of death (e.g. by having held at least 5% of the shares and voting power in a trading company of which he or she was an officer or employee). The message for ER purposes is therefore 'use it or lose it'.

Trustees can claim ER on the disposal of settlement business assets, but only in very limited circumstances. The relief is only available to trustees of settlements in which there is an individual who is a 'qualifying beneficiary'. This is broadly an individual with an interest in possession (but not a fixed term one) in all the trust property, or that part of the trust property including the business assets in question. Only then is ER available, subject to further conditions being satisfied depending upon whether the settlement property comprises business assets (or

interests in them) which are company shares or securities, or assets used for the purposes of a business (TCGA 1992, s 169J).

These conditions mean that ER is not available to the trustees of discretionary trusts. It is therefore important to know what type of trust one is dealing with. Whilst it is relatively straightforward in many cases to distinguish between an interest in possession and a discretionary trust, care is needed. The fact that a settlement is named (say) 'The John Jones Discretionary Trust' or the 'Jane Smith Interest in Possession' trust does not determine their true nature. Only the terms of the settlement will do that.

#### 4. Disappearing concessions

HMRC are considering withdrawing many of their Extra Statutory Concessions (ESCs). This follows the House of Lords' decision in *R v HM Commissioners of Inland Revenue ex p Wilkinson* [2005] UKHL 30, which indicated that HMRC's administrative discretion to make and apply ESCs that depart from the strict legal position is more limited than originally thought.

The good news is that those existing ESCs being withdrawn may become law instead. This is likely to apply to ESCs which are considered to exceed the scope of HMRC's discretion following the *Wilkinson* judgement, where appropriate.

HMRC recently issued a consultation document ('ESCs – Technical Consultation on draft Legislation') on the subject. HMRC propose that a number of ESCs are legislated, but consider that some other ESCs can stay as they are.

#### Concession C16

A further category is 'ESCs where clarification is needed before legislation is drafted'. Included on that list is Concession C16. This is a relatively well-known and often used concession that allows distributions on the informal

winding up of a company to be treated as capital distributions, as opposed to taxable income. Thus it seems that Concession C16 will be withdrawn, albeit seemingly to be put on a legal footing.

#### Companies Act 2006

Since 1 October 2006, private limited companies have been able to reduce their share capital, using a new solvency statement procedure in Companies Act 2006.

A problem with Concession C16 in the past has been that share capital could not be distributed, although in practice the *Bona Vacantia* division of the Treasury Solicitor's department would allow up to £4,000 to be repaid without seeking to recover unlawful excess distributions.

However, by virtue of Companies Act 2006, Part 23 and supporting Regulations, reserves resulting from a reduction of capital are generally treated as distributable 'realised profits' for the purposes of an informal winding up, subject to certain exceptions. Reductions in share capital under the Companies Act 2006 solvency statement procedure generally fall to be treated as capital distributions (within TCGA 1992, s 122).

It will be interesting to see how HMRC deal with Concession C16 following the consultation process in the light of those changes. The consultation document on ESCs can be downloaded from the HMRC website ([www.hmrc.gov.uk](http://www.hmrc.gov.uk)).

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