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## December 2009

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## Editor's comment

This edition of Private Client has been finalised on the afternoon of the Government's Pre-Budget Report. Whilst a one-off super-tax on bank bonuses was widely expected, there was little consensus on what other tax measures might be introduced in this last opportunity before an imminent General Election. The full package amounts to something of a mixed bag, as you will see from our lead article and a short piece on the 50% tax rate.

We also comment on developments at HM Revenue & Customs, in the context of further investigation powers, an increasing willingness to attack aggressive tax planning, and the importance of not just getting the documentation right, but ensuring that practice truly reflects it.

Finally, in the light of much press coverage about International Financial Centres, we highlight the stability and benefits of our offices in Guernsey and Geneva.

**Tim Gregory**

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## Pre-Budget Report *Mixed messages?*

*The Chancellor's 2009 Pre-Budget Report was widely expected either to make no real tax changes at all, for fear of losing imminent General Election votes, or to introduce substantial new taxes on the wealthy, aimed at winning new voters. The reality was somewhere in between, including some measures aimed to hit those deemed to be responsible for the current state of the economy, others that seemed to be designed to create headlines but consist of little substance, and others still that may back-fire.*

### **New tax for bankers**

Where banks or similar institutions pay a discretionary bonus on or after 9 December 2009 in excess of £25,000, the employer bank will be charged a new "Bank Payroll Tax" (BPT) of 50%. This will be in addition to any tax and National Insurance that the individual and the employer would normally have to pay, and the BPT will not itself be tax deductible.

There will be anti-avoidance measures introduced in respect of BPT and, for example, payments through intermediaries have already been identified as something that will not escape the tax. However, it is referred to specifically as an employment tax, and it would seem that the institutions of bankers and similar professionals who are paid other than as employees will not be subject to this tax.

BPT will operate only until 5 April 2010, and so is clearly aimed at the current bonus season: this may be why the Chancellor referred to BPT as a "one-off" tax, but it is more than possible that it could be rolled over into 2010/11. Of course, the top income tax rate then will be 50%, and so there is clearly a risk in simply delaying bonus payments in the hope that the tax bill overall will have reduced in the next tax year.

However, there seems to be little doubt that a prolonged increased tax burden for individuals who could just as easily work outside the UK could only lead to a drain abroad of those with real banking talent.

### **More National Insurance increases**

Although not announced in the Chancellor's speech, further increases in National Insurance Contributions (NICs) will be made. From 5 April 2011, rates for employers, employees and the self-employed were to increase by 0.5%. They will now increase from that date by a full 1%. This means that, on current rate bands, the total NICs in respect of someone with a salary of around £40,000 will be £8,922 in 2011/12, compared to £8,230 in 2008/09, an increase of more than 8%. For businesses that are currently struggling, it seems unlikely that they will be encouraged to invest in new employment.

**A morsel for small companies**

The rate of Corporation Tax for small companies (profits up to £300,000) is currently 21%. This was to increase to 22% from 1 April 2010, but the Chancellor announced that the planned increase would not occur after all. Whilst this is likely to be welcome news for those small companies that are currently making healthy profits, it is the ones making little profit or even temporary losses that would benefit most from a life-line from the Chancellor. Given that this rate cut seems unlikely to cost any significant amount in practice, its effect is going to be little more than a gesture to British enterprise.

**Tax break for inventors, but only if you incorporate!**

From April 2013, there will be a reduced 10% corporation tax for profits derived from patents. The details have not been announced, but the intention is clearly to boost innovation. However, not all innovators operate through limited companies, and this tax incentive seems set to create more regulation for creative people as they find themselves effectively forced to incorporate. With the implementation date over three years away, one might hope that there is time to rectify this.

**Relief on VAT**

After much suggestion in the press that VAT might be increased to a higher rate than 17.5% when the temporary 15% rate ends on 31 December, there will be much relief amongst providers of goods and services to consumers that the rate will indeed return to 17.5%.

**Standing still on Inheritance Tax**

Inheritance Tax (IHT) has been something of a media hot potato in recent years, in both the media and politics. If there is any indication of public opinion in this area, it is that more and more people are startled that they are affected by it.

It is therefore surprising that the nil rate band, above which IHT is charged, is to be frozen at £325,000 for next year, instead of it being increased to £350,000 as previously planned. With total tax receipts from IHT known to be a very small proportion of all taxes, this is unlikely to have much fiscal effect, but seems designed as a political move.

**Not in the Pre-Budget Report**

Perhaps the most surprising element of the Pre-Budget report was an omission: Capital Gains Tax. In spite of widespread fears of a substantial increase in the CGT rate, there have been no significant changes in this area at all.

**Anti-avoidance**

As is now routine, there were several announcements aimed at closing specific tax schemes and planning opportunities, and this received one of the biggest cheers from the House as it arose in the Chancellor's speech. Whilst there is no doubt that people should not be illegally evading their tax responsibilities, the expected total tax receipts from action in this area suggests that there is much less "unacceptable" tax avoidance going on than one might be led to believe by the press and the cheers from Parliament. These measures are expected to protect £5 billion of tax revenue, which is around only a half of 1% of each of both tax revenues and the UK's total debt. No doubt tax avoidance is considered to be a convenient scapegoat for the much more serious issues that need to be addressed by our politicians.

# Information request powers

## *HMRC's growing teeth*

***Substantial new powers to obtain information on a taxpayer now exist for HM Revenue & Customs (HMRC) under Finance Act 2008. These powers are intended to improve the effectiveness of discovering and combating non-compliance for all taxes.***

The new framework introduced a common compliance checking structure that applies to Income Tax, Capital Gains Tax, Corporation Tax, VAT, PAYE, National Insurance and the Construction Industry Scheme from 1 April 2009, and other taxes such as Inheritance Tax and Stamp Duty Land Tax from 13 August 2009.

Whilst these powers have now existed for some time, it is only in the last few months that the extent of HMRC's intention to use them has become apparent. If they have reason to believe there is something wrong, HMRC is now able to issue a Taxpayer Notice (TN), which requires a taxpayer to provide information or produce a document without the opening of an official enquiry into the taxpayer's affairs, as was previously the case. The TN does not need to be issued for determining whether a return is incomplete" but merely for the purpose of "checking the taxpayer's tax position". This therefore allows HMRC to inspect records both before a return is filed, and after the "enquiry window" (generally one year after the relevant tax return has been filed) has closed.

HMRC is now also able to obtain information or documents from third parties, through a Third Party Notice (TPN).

"Information", in these contexts, covers explanations and the creation of schedules and documents that do not already exist and so there may be additional resource burdens on tax payers who find themselves to be subject to these checks.

Although HMRC has previously had to allow at least 30 days for the production of information, this requirement has now been removed, and so HMRC are effectively free to impose whatever ("reasonable") deadline they wish.

HMRC has always been able to request documentation from both the taxpayer and third parties but now information can be requested that may put both the taxpayer and any third parties in a difficult situation as to what information should reasonably be supplied. If these Information Notices are received from HMRC, do check that they have sufficient authority for the request and obtain advice before providing any documentation or information.

# The aggression escalator

## **Aggressive tax planning is leading to an equally aggressive reaction from the revenue**

*Claiming a relief or repayment should be an issue between the taxpayer and HMRC. However, as schemes become more aggressive, it becomes more widely debated and the labels more aggressive and sinister. In a Written Ministerial Statement dated 21 October 2009, the Financial Secretary to the Treasury, Stephen Timms, writes "there are a minority who continue to seek ways to avoid paying their fair share. This is unacceptable... This Government will not tolerate tax avoidance or tax evasion in any form, and will act promptly to tackle both of these". Although you may not agree with his use of "tax avoidance" in this paragraph, there is no denying the feelings being conveyed.*

Outside tax professional circles Stephen Timms was also reported in The Telegraph on 21 September 2009 ("Stephen Timms: tax avoiders 'rob' hard-working families") as saying that this practice is "corrosive and it needs to be tackled head on, and recognised for the damage it does" and that "the tax cheats would be pursued more vigorously than ever before".

### **The disclosure regime**

HMRC is made aware of tax schemes through the disclosure regime introduced from 1 August 2004 and extended to 1 August 2006 which requires certain tax advantage schemes to be reported to HMRC. As a result, regardless of whether HMRC agree whether a scheme works or not, rules are introduced with immediate effect to counter the perceived advantage.

### **Schemes closed**

It is interesting to note that the Written Ministerial Statement referred to above is titled "Anti-Avoidance" and announces changes to the legislation to take immediate effect concerning schemes that took advantage of either the sideways loss relief provisions or the application of Double Tax Treaties using Unauthorised Unit Trusts, Manufactured Overseas Dividends or Manufactured Interest.

### **Court decisions**

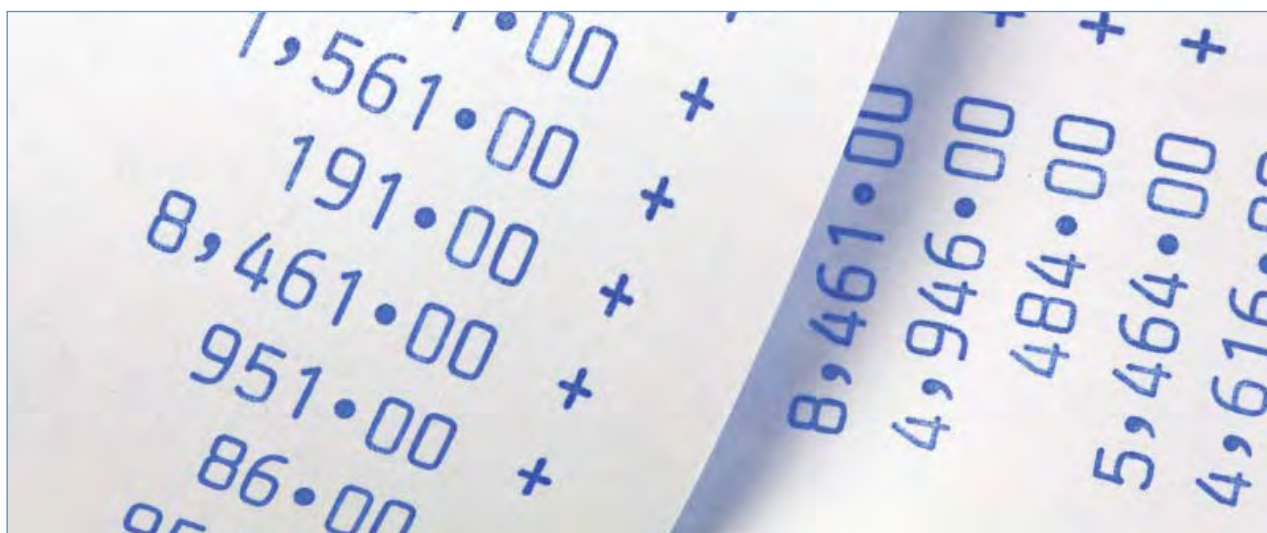
In a recent case at the Court of Appeal which dealt with a life insurance policy scheme to generate substantial capital losses, *Drummond v Revenue and Customs Comrs* [2009] STC 2206, Rimmer LJ observed "The interpretation of legislation involves more than black letter literalism" and "In a case such as the present... it is necessary to give the statute a purposive construction".

### **Conclusion**

The UK's net debt at the end of October 2009 was almost £900bn, and tax receipts are falling. Ignoring any moral argument that may be waged for or against tax avoidance schemes, the UK needs all the money it can get, and therefore denial of reliefs is to be expected.

An unfortunate addition to all this is that the highest rate of income tax is due to increase to 50% from 2010-11. This is only going to encourage more schemes to be devised as we creep up the Laffer Curve.

So the stage is set where taxpayers' appetite for schemes will increase and HMRC will look to deny relief where possible. Is this the prelude to a General Anti-Avoidance Rule?



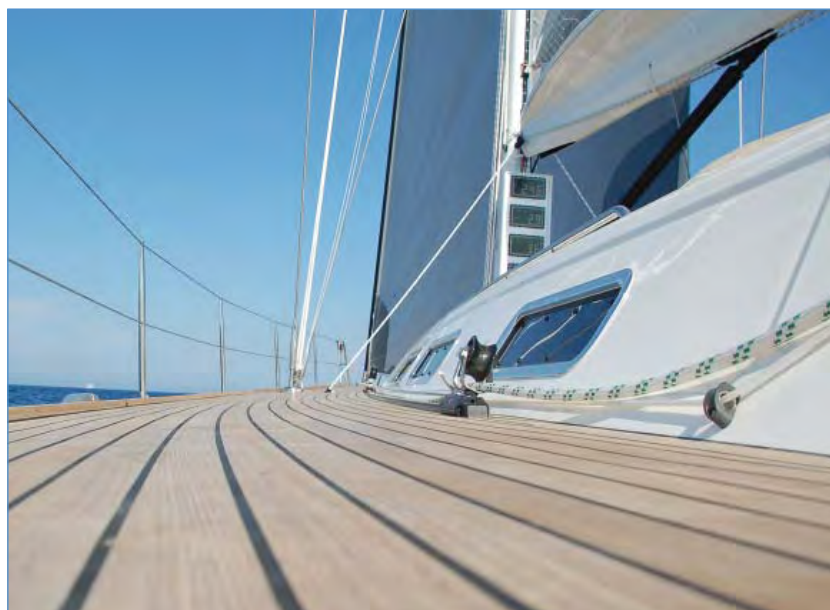
## Tax case news – *Laerstate BV (TC 162)*

*A company will be resident in the UK for tax purposes if it is incorporated here, but also a foreign incorporated company will be resident in the UK if it is managed and controlled here. This is often a key issue in international corporate tax planning and also wealth planning for high net worth individuals, and so the meaning of “management and control” is carefully scrutinised.*

For family situations in particular, UK-based family members may seek to influence the directors of family companies based outside the UK tax net, and the extent to which this influence can be exerted without bringing the worldwide profits of the company within the ambit of UK corporation tax is the subject of close attention by HMRC.

Until recently the relevant case on this subject was *Wood v Holden* [2006], where the taxpayer was victorious at the Court of Appeal. The effect of this case, very broadly, was that it is acceptable for the directors of an overseas company to fall in with an overall plan which was designed by equity holders in the UK, so long as the overseas company directors exercise (and are seen to exercise) careful consideration of the merits and disadvantages of the plan, and that it is those overseas directors who have the final say as to whether the overseas company takes part.

The Revenue has been seeking to win a case of their own on this subject, and has now done so with their First Tier Tribunal win in the case of *Laerstate BV*.



The *Laerstate* case is arguably of limited use for HMRC as it has a number of factors which are unusual. For example, one director of that company had the power to bind the company on his own even against the express wishes of the other director, and that powerful director was resident in the UK. Nevertheless, there are points to take away, including the major issue that the Tribunal decided that despite the fact that the board meetings of the company took place outside the UK, the company was not run by the directors at its board meetings. Instead it was found that the UK resident director took all the decisions himself outside of the board meetings. In addition, the Tribunal was relatively uninterested in the location in which documents were signed – a point which had previously been thought to have been of some importance – preferring to concentrate on where the decision to sign was taken.

There are a number of lessons to be learned from the *Laerstate* case, but the common thread among them is one which will be familiar to those who prepare accounts, the principle of “substance over form”. This means that the way that things actually happen is much more important than the way that they are supposed to happen. In our experience the factor that most often undermines tax planning in this area is that the legal structures and protections put in place at the planning stage are not adhered to in practice, and the *Laerstate* case provides an example of the way that this can go wrong.

## Preparing for the 50% tax rate

Many advisers to private clients have published their thoughts on what can be done by individuals in the face of the 50% tax rate that is due to come in from 6 April 2010, on incomes over £150,000. Our own technical brief on this topic, prepared before the Pre-Budget Report, can be viewed on our website, [www.saffery.com](http://www.saffery.com). With the obvious exception of Bank Payroll Tax (see our lead article), little has been done to prevent planning in this area.

There can be no doubt now that the 50% rate is going to become a reality, regardless of which political party is in power after the General Election in the Spring, and it seems likely that the rate will remain for some years at least. To find out how we can help you to minimise its impact for you and your family, please contact your usual Saffery Champness partner.

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## Stormy waters, *but steady course*

Some of the key characteristics of International Financial Centres (IFCs) have traditionally been discretion, privacy and, for some banks in particular, secrecy. All of that has been challenged in recent months, with an increasingly intense spotlight on the activities of the jurisdictions, organisations and especially individuals involved in these arrangements.

On the one hand, most would say that people who have illegally evaded tax through the use of secret bank accounts should only have expected their past to catch up on them and, in the UK at least, the various "amnesties" that have been available so far have been nothing short of generous.

However, whilst there has been much negative press about IFCs, their advantages within national and international legal and tax systems should not be forgotten. Quite apart from the benefits to individuals and organisations of discretion and privacy (within all laws and tax systems), there have also been a number of reports showing that IFCs are beneficial to the wider economy of those countries with which they are associated. Whilst IFCs will quite rightly lose business from people who have been hiding their money from the taxman, properly-advised structures will remain intact and continue to offer substantial advantages to the families served by them.

Our offices in Guernsey and Geneva operate under the highest standards of regulation and transparency in relevant tax information. Readers close to Saffery Champness will be aware that Guernsey has been established for over 30 years, whilst Geneva is currently celebrating its first birthday, after a stronger-than expected first year. Both jurisdictions have strong reputations and neither office has experienced any significant issues arising from the extensive negative press and increased scrutiny of IFCs generally.

All of the opportunities for private clients with international interests remain available through our Guernsey and Geneva offices, which have experienced overall expansion that we expect to continue. For more information on the services offered by these offices, please do not hesitate to contact us.

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