Oliver Marre
Tax Chambers, 15 Old Square,
Lincoln's Inn, London WC2A 3UE
T: (020)7242 2744 F: (020)7831 8095
taxchambers@15oldsquare.co.uk

TAX CHAMBERS
15 OLD SQUARE

Recent developments in private client tax

Oliver Marre[1]

1. CGT private residence relief

1.1. Reduction in time: clause 54 FB 2014

The basic principal private residence relief is set out in s. 222 TCGA 1992. This applies to property which is (a) a dwelling-house or part of a dwelling-house which is, or has at any time in his period of ownership been, a taxpayer's only or main residence, and (b) land which the taxpayer has for his/her own occupation and enjoyment with that residence as its garden.

Where a person owns one or more properties that have been his/her main residence he/she is entitled to relief on the final period of ownership even if he/she has not been living in it immediately before it is sold.

The measure will reduce the period of ownership for which this relief is available from 36 months to 18 months. This is done by amending s. 223 TCGA 1992:

> (1) No part of a gain to which section 222 applies shall be a chargeable gain if the dwelling-house or part of a dwelling-house has been the individual's only or main residence throughout the period of ownership, or throughout the period of ownership except for all or any part of the last ~~36 months~~ 18 months of that period.
> (2) Where subsection (1) above does not apply, a fraction of the gain shall not be a chargeable gain, and that fraction shall be—
>> (a) the length of the part or parts of the period of ownership during which the dwelling-house or the part of the dwelling-house was the individual's only or main residence, but inclusive of the last ~~36 months~~ 18 months of the period of ownership in any event, divided by
>> (b) the length of the period of ownership.
>> …
>
> (7) In this section—
>> "period of absence" means a period during which the dwelling-house or the part of the dwelling-house was not the individual's only or main residence and throughout which he had no residence or main residence eligible for relief under this section; and
>> "period of ownership" does not include any period before 31st March 1982.

This measure will have effect where contracts for the sale of the property are exchanged on or after 6 April 2014.

[1] olivermarre@15oldsquare.co.uk; 0207 242 2744

Oliver Marre
Tax Chambers, 15 Old Square,
Lincoln's Inn, London WC2A 3UE
T: (020)7242 2744 F: (020)7831 8095
taxchambers@15oldsquare.co.uk

There is an exception to the shorter final period for people moving into care. HMRC say this is "in recognition that a person may take longer to decide to dispose of their former home". For people moving into care, the final period will remain 36 months.
Is the reasoning convincing?

> 225E Disposals by disabled persons or persons in care homes etc
> (1) This section applies where a gain to which section 222 applies accrues to an individual and—
> (a) the conditions in subsection (2) are met, or
> (b) the conditions in subsection (3) are met.
> (2) The conditions mentioned in subsection (1)(a) are that at the time of the disposal—
> (a) the individual is a disabled person or a long-term resident in a care home, and
> (b) the individual does not have any other relevant right in relation to a private residence.
> (3) The conditions mentioned in subsection (1)(b) are that at the time of the disposal—
> (a) the individual's spouse or civil partner is a disabled person or a long-term resident in a care home, and
> (b) neither the individual nor the individual's spouse or civil partner has any other relevant right in relation to a private residence.
> (4) Where this section applies, the references in section 223(1) and (2)(a) to 18 months are treated as references to 36 months.
> (5) An individual is a "long-term resident" in a care home at the time of the disposal if at that time the individual —
> (a) is resident there, and
> (b) has been resident there, or can reasonably be expected to be resident there, for at least three months.
> (6) An individual has "any other relevant right in relation to a private residence" at the time of the disposal if—
> (a) at that time—
> (i) the individual owns or holds an interest in a dwellinghouse or part of a dwelling-house other than that in relation to which the gain accrued, or
> (ii) the trustees of a settlement own or hold an interest in a dwelling-house or part of a dwelling-house other than that in relation to which the gain accrued, and the individual is entitled to occupy that dwelling-house or part under the terms of the settlement, and
> (b) section 222 would have applied to any gain accruing to the individual or trustees on the disposal at that time of, or of that interest in, that dwelling house or part (or would have applied if a notice under subsection (5) of that section had been given).
> (7) In the application of this section in relation to a gain to which section 222 applies by virtue of section 225 (private residence occupied under terms of settlement)—
> (a) the reference in subsection (1) of this section to an individual is to the trustees of the settlement;
> (b) the references in subsections (2) to (6) of this section to the individual are to the person entitled under the terms of the settlement, as mentioned in section 225.
> (8) In this section—
> "care home" means an establishment that provides
> accommodation together with nursing or personal care;
> "disabled person" has the meaning given by Schedule 1A to FA 2005.

1.2. Consultation to end PPR elections

Under the current system an individual with more than one residence can choose which of those properties they would like to qualify for PRR. They do this by notifying HMRC of their election.

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There was a consultation released last month entitled "Implementing a Capital Gains Tax charge on non-residents."

This includes consulting on a change to the election rules. The consultation suggests two possible new rules:

> 1 Remove the ability for a person to elect which residence is their main residence for PRR. This would mean that PRR would be limited to that property which is demonstrably the person's main residence. The government envisages that this would build on the existing process that applies where an individual with two or more residences has not made an election. In these cases, the person's main residence is determined by the balance of all the evidence including factors such as the address where the taxpayer's spouse or family lives, mail is sent, and that is on the electoral roll.
>
> 2 Replace the ability to elect with a fixed rule that identifies a person's main residence e.g. that in which the person has been present the most for any given tax year.
> Depending on the test that is devised this may mean that taxpayers have to keep different or additional records.

The first is more flexible; the second more certain.

What people will be able to do if the ability simply to elect is withdrawn will depend on the precise terms of the amended legislation. If there is a day count, and it is practical, then simply ensuring you are on the right side of the day count will be enough. Otherwise, if one or both properties are lived in by more than one person, think about ownership of each; or think about ownership via a trust.

1.3. What is a residence?

Recently there has been a flourishing in legislation on the question of what is a residence. This should remain relevant. HMRC has been clamping down – previously, taxpayers would make an election and nothing more would be said.

Michael J Harte and Brenda A Harte v HMRC [2012] discovered that more tenuous claims of residence will be challenged. They made an election and moved in for just eight days. The Tribunal found that this was not a residence at all as they never formed an intention to live there permanently.

It is worth asking what guidance can be given to clients on how to ensure that a claim for PPR does not fail because the property in question is not a residence at all.

In *Moore v HMRC* [2010] UKFTT 445 (TC), a house was bought as a prospective family home, at which point the taxpayer moved in to renovate it. However, his

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fiancée hated it – in the words of the judge "would not countenance living there". It was held not to be the taxpayer's residence on romantic grounds, as the taxpayer was always fully committed to his relationship.

In *Moore*, Judge John Walters QC helpfully summarises the earlier authorities in relation to the issue of 'residence' as follows:

> "A residence for these purposes must be a person's 'home' (*Sansom v Peay* 52 TC 1at 6G), 'a place where somebody lives' (*Frost v Feltham* 55 TC 10 at 13I). However, 'even occasional and short residence in a place can make that [place] a residence' (*Moore v Thompson* 61 TC 15 at 24E).
>
> [In] *Goodwin v Curtis* 70 TC 478…the Court of Appeal … was unanimous in the view that 'there must be some assumption of permanence, some degree of continuity, some expectation of continuity to turn mere occupation into residence' (ibid. at 508I, 510H)."

More recent cases have applied this:

Clarke v HMRC [2011] UKFTT 619 (TC) – after a divorce, the taxpayer took a development loan from a bank to finance the acquisition of a property, which he said to the bank would be developed and sold. He claimed that it was his PPR during renovation. The taxpayer explained to the FTT that his loan application was made to secure quick funding and that he in fact inhabited the property for some months, until wife disappeared and he then moved back to marital home. Held to have been a residence.

Benford v HMRC [2011] UKFTT 457 (TC) – the taxpayer went through a v short marital separation, when he bought a house in bad disrepair. He sold it and moved back in with his wife. There were electricity bills showing very little usage. It never became his residence. One relevant question was whether there was ever a real intention to live separately from his wife. Held not to have been his residence.

Bradley v HMRC [2013] UKFTT 131 (TC) – the taxpayer owned several properties. Her husband lived in one, and she moved into another, which she sold sometime later. Held not to have been her residence, it being noted that she had advertised the house for sale before moving into it.

D Morgan v HMRC [2013] UKFTT 181 (TC) – a man lived in a property for six months out of seven years of ownership, due to complicated personal circumstances. However, when he moved in he had the intention to make it his home and unconnected factors intervened. Held to have been his residence. Lack of furniture was not held to be relevant.

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P Moore v HMRC [2013] UKFTT 433 (TC) – a man bought a house, and rented it out. He moved into it some years later, when he left his wife. However, when he left the marital home, he arranged for his post to be forwarded to the house of his new partner. He lived in the house for a matter of weeks and it was held it never became his residence at all.

Gibson v HMRC [2013] UKFTT 636 (TC) – house demolished and another house built in its place. The taxpayer lived in the first but not in the second. HMRC argued that the two houses were so different in layout that they were not the same dwelling. The FTT rejected this. It is a question of degree: the Tribunal was split on whether an entirely new construction (rather than a major renovation) can be the same "dwelling house" as the previous house on the same site. Took into account none of the materials from the old house were reused. Judge with casting vote held it was not the same dwelling house and so not the same residence.

What to note: fact specific – retain documents that demonstrate residence; length of occupation indicative but not decisive provided there is a reasonable explanation for short periods; intention is given considerable weight. Spurious claims less likely to be waved through. Renovations permitted but it is a question of degree.

2. **The extension of ATED**

2.1. Reduction of threshold from properties valued at £2m to properties valued at £1m.

The Annual Tax on Enveloped Dwellings (ATED) is currently imposed on residential property which is worth more than £2m and is held in a company or other non-natural person.

Rather than prompting large numbers of people to unwind the structures that fall within the ATED charge, this has been raising substantial revenues as people have opted to pay the annual charge. In each case it is a question of balancing IHT benefits of retaining corporate structure; costs of unwinding, including charge to CGT; and cost/cash-flow of paying the ATED.

ATED is now being extended.

Clause 103 FB 2014 amends s. 99 FA 2013 so that for enveloped properties in a new £1m to £2m band, the annual tax is £7,000.
This has effect from 1 April 2015.
The valuation date is still 1 April 2012.

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On 6 April 2015 the CGT charge on selling property with ATED-related gains will be extended. There will be rebasing to that date.

The tax payable on enveloped dwellings are linked to the Consumer Price Index.

Chargeable amounts for chargeable period 1 April 2014 to 31 March 2015

Property Value	Annual Chargeable Amount 2014 to 15
More than £2m but not more than £5m	£15,400
More than £5m but not more than £10m	£35,900
More than £10m but not more than £20m	£71,850
More than £20m	£143,750

People affected by the new band will have until 1 October 2015 to file their first ATED return and until 31 October 2015 to pay the charge. Thereafter the usual ATED filing and return date of 30 April will be effective.

2.2. Reduction of threshold from properties value at £1m to properties valued at £500,000

From 1 April 2016 there will be a further new band introduced:
Properties valued at more than £500,000 but not more than £1m will be subject to an annual tax of £3,500.
(Clause 104 FB 2014).

On 6 April 2016 the CGT charge on selling property with ATED-related gains will be extended. There will be rebasing to that date.

There does not seem to be any extension to the filing and payment date for this in the first year.

There is time to unwind properties worth between £500,000 and £2m from holding structures that would cause them to fall within ATED. It is therefore time to think about the pros and cons of retaining the structure. (The IHT benefit on lower value properties is less.)

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2.3. SDLT extension

The 15% flat rate SDLT charge on "high value" enveloped dwellings is extended by redefining "high value" from £2m to £500,000 from 20 March 2014.
(Clause 105 FB 2014).

3. **Accountants' negligence after the appeal in *Mehjoo v Harben Barker* [2014] EWCA Civ 358**

When this case was heard in the High Court it drew a lot of comment. Silber J held that an accountant had been negligent because he had a duty to advise a client that he may have been a non-dom and should have told him to consult an appropriate tax specialist to consider what considerable tax avoidance opportunities might be legitimately available to him. In that event, the court held that the client may then have saved the CGT on the sale of his business.

This was widely reported as imposing a duty on advisors to give advice on avoidance strategies, which was not quite what it said.

This has been overturned by the Court of Appeal. Does this mean that tax advisors can now safely not advise on tax avoidance strategies and, if so, what about other tax planning arrangements?

Whether or not there is a duty to tell clients to seek specialist advice, and whether or not it is negligent not to do so, it would have been good advice in this case and will often be good advice.

The CA approach was to examine closely the terms of the retainer between the accountant and his client. This is in line with the old case law. So, at the other end of events, the terms of the retainer must be thought about carefully. In this case, the retainer provided for: "general tax planning advice on the best use of reliefs" and so evidently not specialist tax planning advice.

The CA then asked whether the terms of the retainer had been varied by conduct. In this case, the degree of advice provided beyond what was set out in the retainer was not, the CA held, sufficient to amount to a variation of the retainer so as to widen its scope to encompass advice on tax avoidance schemes:

> Routine tax advice of this kind[2], though an important part of an accountant's ordinary duties, is not what this case is about. And Mr Stewart is, I think, right in his submission that much of the difficulty with the judge's analysis of the scope of HB's retainer and duty of care

[2] i.e. the kind provided by the accountants in this case – general advice as to tax consequences of transactions.

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Lincoln's Inn, London WC2A 3UE
T: (020)7242 2744 F: (020)7831 8095
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> stems from a failure to differentiate between the tax advice of the kind which Mr Purnell gave to Mr Mehjoo on the occasions referred to by the judge and the much more sophisticated form of tax planning exemplified by the BWS which often involves a re-formulation of the transaction in order to bring about particular tax consequences rather than a mitigation of the tax liability which the transaction will otherwise produce.

The CA also pointed out that the taxpayer had been advised that "Various tax saving schemes may be available subject to up-front fees and uncertainty regarding Government action".

What lessons can then be drawn? First, the importance of the retainer. Do you want to contract out of any advice on tax planning schemes, including even their existence? You are free to do so. Is it commercially sensible? Second, the importance of ensuring you do not vary the retainer accidentally. Third, that it is a good idea if an advisor wants to offer general tax advice, at least to be aware of more complex planning opportunities so that you can take a view as to whether you want to advise on them or to advise that further specialist advice should be sought.

4. **Nil rate band drafting after *Loring v Woodland Trust* [2013] EWHC 4400**

A will contained the following clauses:

> (5) MY TRUSTEES shall set aside out of my residuary estate assets or cash of an aggregate value equal to such sum as is at the date of my death the amount of my unused nil rate band and to hold the same for such of the following as shall survive me and in the case of grandchildren attain 23 and if more than one in equal shares absolutely. [The names of the beneficiaries are then set out]…
>
> (6) Subject as aforesaid my Trustees shall hold the remainder of my estate for the Woodland Trust of Autumn Park Grantham aforesaid absolutely..."

The deceased had been married and her husband had predeceased her.

At the time the will was written, NRBs were not transferable, but by the time of the testatrix's death, any amount of the NRB that was not used by the spouse to die first could (still can) be transferred to the remaining spouse.

The question was, therefore, whether the cash gift should have been of the amount of one NRB or the amount of the combined NRB of the deceased and her pre-deceased husband.

The difference was a residual gift to charity worth only £30,805 or a much more considerable one of £355,805.

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Under s. 8A IHTA 1984, the executors may make an election as to whether to transfer the spouse's unused NRB, at which point the new aggregate amount is retrospective to the time of death:

> (1) This section applies where -
>
> > (a) immediately before the death of a person (a "deceased person"), the deceased person had a spouse or civil partner (the "survivor"), and
> >
> > (b) the deceased person had unused nil-rate band on death.
>
> (2) A person has unused nil-rate band on death if –
>
> > M > VT
>
> (3) Where a claim is made under this section, the nil-rate band maximum at the time of the survivor's death is to be treated for the purposes of the charge to tax on the death of the survivor as increased by the percentage specified in sub-section (4) below..."

It was argued for the charity that the "amount of my unused nil rate band" must be the amount of a single NRB; and for the residuary beneficiaries that the amount must be the total amount of NRB available to the testatrix.

The judge held, on the basis of the retrospective action of s. 8A IHTA 1984 that the correct construction was that the NRB should be taken to incorporate the unused NRB of the testatrix's predeceased spouse.

It is notable that at least some of the pecuniary of this decision were the same as the executors of the will, who made the election to transfer the NRB.

What of the argument that they were therefore conflicted?

What would the result of this argument have been? They ought to have applied to the court for directions. Having failed to do this, were they in breach of their fiduciary duties? Do they in fact hold the amount of the second nil rate band on trust for the charity? (If they had not made the election, the gift to charity would anyway not have been a chargeable transfer for inheritance tax purposes (s. 23 IHTA 1984).)