Briefing

Private client review for January

Speed read

This month, we comment on a couple of taxpayer victories concerning the income tax treatment of dividends: in *Gould*, the FTT held that an interim dividend was taxable when actually paid, rather than declared; in *Jays*, a similar finding held that part of a dividend declared but not actually paid did not trigger tax. *Hopes v Burton* continues the trend of taxpayers being able to rely on the doctrine of mistake to remedy transactions where unforeseen tax consequences arise. *Futcher* acts as a timely reminder that difficult personal circumstances will not necessarily constitute a 'reasonable excuse' or 'special circumstances' to avoid penalties on the late filing of a personal tax return. Two further SDLT cases, *Withers* and *Ridgway*, continue the tribunals' exploration of what constitutes 'mixed use'. Finally, we note the continued plethora of HMRC nudge letter campaigns.

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Reaping the dividends

It is reasonably rare to see reported cases on dividends, rarer still to see (no less than two) dividend cases where the taxpayer wins.

In *Gould v HMRC* [2022] UKFTT 431 (TC), the directors of a company resolved to pay an interim dividend. The amount due to one shareholder was paid promptly, but the sum owed to a second shareholder was paid several months later, in the following tax year, by which point that shareholder was non-UK resident and so not taxable in the UK.

Interim dividends are subject to income tax in the hands of the shareholder when they become 'due and payable'. HMRC argued that the interim dividend was enforceable by the second shareholder as against the company as soon as the first shareholder had been paid, and so the interim dividend became 'due and payable' (with both shareholders liable to tax) on the date of payment to the first shareholder.

The FTT rejected this argument, holding that, where an interim dividend is declared but not paid, the relevant date for tax purposes is the date on which it is actually paid (and is therefore 'due and payable') to the relevant shareholder, and not the date on which it is declared or paid to any other shareholder, even where one shareholder is paid immediately and the other is not paid until much later.

In *Jays and another v HMRC* [2022] UKFTT 420 (TC), a company declared a series of dividends over several tax years. Some payments were actually made to the shareholders but, in light of the company's financial difficulties, an agreement was made with its bank that other amounts would be credited to a blocked account on which the shareholders were unable to draw.

Despite HMRC's arguments to the contrary, the FTT held that, although the dividends had been declared and paid (into the blocked account), since those sums were 'inaccessible' to the shareholders, they were not deemed to be 'paid' for income tax purposes.

Whilst these are encouraging decisions for taxpayers, HMRC may well appeal, so the findings should not yet be taken as gospel. Furthermore, there are nuances to bear in mind. For example, *Gould* drew a distinction between interim and final dividends: an interim dividend will not be taxable until actually paid, whereas a final dividend will generally be taxable as soon as declared.

There's still hope: trustee appointments rescinded on the ground of mistake

Hopes v Burton [2022] EWHC 2770 (Ch) concerned a successful mistake application relating to a life policy settlement.

The trust property was held on 'old style' life interest trusts for four family members. The trustees signed deeds of appointment intended to appoint one of the four shares onto new discretionary trusts, while leaving the other three life interests undisturbed.

Readers familiar with the 2006 changes to the inheritance tax profile of such interests ('qualifying interests in possession') will guess what's coming next. Rather than leaving three of the four life interests untouched, the trustees effected a resettlement of the entire trust fund. The result was an immediate inheritance tax charge of £365,000 (plus interest). Furthermore, the trust fund shares became subject to ongoing inheritance tax charges under the relevant property regime.

Upon realising their error, the trustees applied to have the appointments set aside. The court agreed to do so, applying the principles established by the Supreme Court in *Pitt v Holt* [2013] STC 1148 on the rescission of voluntary dispositions on the ground of mistake. In short, that decision confirms that a disposition may be rescinded where (a) there has been a mistake; (b) that mistake is sufficiently grave as to render it unjust for the donee to retain the property received; (c) the mistake must usually concern the factual or legal nature of the transaction; and (d) the court must ask whether it would be unjust to leave the mistake uncorrected having regard to the consequences. At its heart, the relief ought to be available where a donor intended X but in fact achieved Y.

Here, the court was satisfied that the trustees fell squarely within the requirements for the relief. Witness evidence and correspondence with advisors made clear that the trustees had been labouring under the misapprehension that they were 'entering into a "vanilla" transaction as to its tax consequences'. They were mistaken in their belief that the transaction 'had no adverse tax consequences, or, at the very least, that there was no risk of adverse consequences.'

Practitioners will be encouraged that this case went the way one would have expected. That said, the relief will not be available in all cases (particularly, where the subject of the transaction is itself a complex tax mitigation arrangement) and so the doctrine of mistake should not be thought of as a 'get out of jail free card' when it comes to unforeseen tax consequences.

Late filing penalties: the limits of 'reasonable excuse' and 'special circumstances'

In *Futcher v HMRC* [2022] UKFTT 401 (TC), Mr Futcher failed to file his tax return for 2015/16 by the deadline of 31 January 2017. The return was eventually filed in August 2019.

HMRC issued the taxpayer with a penalty under FA 2009 Sch 55 para 6, which relates to returns filed more than 12 months late. Such penalties are levied where a taxpayer deliberately withholds information which would enable HMRC to assess that taxpayer's liability to tax. The way in which the penalty is calculated depends on the type of information withheld and whether the withholding was merely deliberate, or both deliberate and concealed. The penalty charged to Mr Futcher was 35% of his tax liability. He appealed.

The questions for the tribunal were whether Mr Futcher had a 'reasonable excuse' for failing to file his return, and whether HMRC ought to have reduced the penalty because of 'special circumstances'.

The principles on 'reasonable excuse' were set out in *Christine Perrin v HMRC* [2018] UKUT 156 (TCC): '[the tribunal should] ask itself the question 'was what the taxpayer did (or omitted to do, or believe) objectively reasonable for this taxpayer in those circumstances?" A key timing point is that the reasonable excuse must be interpreted by reference to circumstances existing at the relevant filing date.

In this case, the taxpayer had chosen not to file his return in January 2017 since he had been unable to afford the tax bill at that time. He had intended to delay his filing by only a few months; however, his business then got into serious financial difficulty, negatively impacting his health, which was later compounded by the pandemic. Putting aside their sympathy for Mr Futcher, the tribunal found that his business difficulties and health troubles gave him no reasonable excuse for failing to file on time, since these circumstances had developed after the deadline.

In then considering whether any 'special circumstances' applied, the FTT cited the case of *McCulloch v HMRC* [2018] UKFTT 277 (TCC), in which the taxpayer had been unable to file in time due to technical difficulties and had then been further delayed when he was hospitalised. In that case, the taxpayer's illness was not a reasonable excuse (as it came after the filing deadline), but it was a special circumstance which justified the cancellation of penalties. By contrast, throughout the period of Mr Futcher's ill health, he had retained the capacity to deal with his tax affairs, but had chosen not to do so (this was similarly damning for the taxpayer in *Harrison*, covered previously in this column): there were no special circumstances justifying a reduction in penalty.

As we draw closer to 31 January, this case serves as a timely reminder of the importance of complying with filing deadlines. A deliberate failure to comply can result in a large tax penalty.

SDLT: further developments in the field of 'mixed use'

Developments around the application of mixed-use SDLT rates continue apace.

Readers may recall our previous discussions of various mixed-use cases, notably *Hyman* [2022] EWCA Civ 185, which have largely been a string of wins for HMRC. The case of *Withers v HMRC* [2022] UKFTT 433 (TC) marked a rare victory for the taxpayer.

The purchased property comprised some 39 acres (around 22 football pitches to those of us who are less agriculturally numerate). The purchaser, Mr Withers, accepted that this included around 12 acres of dwellings, gardens and grounds including two barn conversions, a swimming pool, orchard, and a paddock. As to the remaining acres, Mr Withers argued that these were non-residential, on the basis that they comprised grazing land and woods subject to an agreement with the Woodland Trust.

The FTT accepted Mr Withers' arguments concerning both parcels of land. Two points emerge. First, the grazing land had been let to the local farmer for a continuous period of more than 20 years, on a nominal rent. The FTT accepted that the grazing land was used for a separate purpose, notwithstanding that the rent was merely nominal. Of relevance was the fact that the farmer maintained the land, saving the taxpayer upkeep costs. Second, the FTT accepted that the Woodland Trust land did not serve as gardens or grounds of the dwelling. It was instead used for a separate purpose, albeit one that was not commercial; that purpose was the rewilding of the land with a view to enabling a natural habitat to flourish.

The decision is a great example of the detailed, holistic factual analysis the tribunal undertakes when assessing whether land constitutes the 'garden or grounds' of a dwelling. Practitioners will be familiar with the factors to be considered, such as the size, layout, use, access to and marketing of the property.

Objectively, land will be non-residential if it is used for some 'separate purpose' distinct from the dwelling in question. Until now, it has seemed likely that the only separate purpose that might be relevant would be commercial use, but this case clarifies that land may be non-residential owing to a separate purpose that is not commercial.

Meanwhile, in *Ridgway v HMRC* [2022] UKFTT 412 (TC) (an April 2022 decision only recently made available), the taxpayer purchased two buildings and arranged – as a pre-condition of the purchase – that one should be made subject to a commercial lease. The lease was put in place two weeks prior to completion. SDLT was paid at mixed-use rates.

The FTT accepted that the commercial lease had to be taken into account in judging whether the building constituted a dwelling as at completion. However, the anti-avoidance rule in FA 2003 s 75A applied. As such, SDLT was charged on a notional sale-and-purchase which ignored the existence of the lease.

Residential rates therefore applied (although Mr Ridgway was entitled to multiple dwellings relief on the notional transaction despite not having claimed that relief, resulting in an effective 'draw' with HMRC).

The case is a reminder, if any were needed, that artificial efforts to achieve SDLT savings by claiming mixed-use will usually fall foul of anti-avoidance rules.

Yet more nudges

HMRC's nudge letter campaign continues to expand, with an ever-growing list of situations in which HMRC consider the taxpayer to need an additional reminder. Current targets include landlords who may have under-declared rental income or who have disposed of a property, claimants of business asset rollover relief, those claiming deferral relief under the EIS on crystallising deferred gains, and PSCs who have disposed of shares (and have therefore been removed from the PSC register) but not reported any gains.

HMRC is also inviting taxpayers with complex affairs to have discussions with an HMRC officer before filing their 2021/22 returns – an expansion of a similar exercise carried out last year – to point the taxpayer in the right direction as to HMRC guidance or clearance services.

HMRC's joined-up use of data clearly continues apace. ■