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WELCOME

Welcome to the Spring edition of Tax Pulse. We do hope you managed to stay dry over the last few months, when wet weather records went tumbling – the sixth wettest April the UK has experienced since 1836 and the wettest February on record for the South East too. How we do love a weather statistic in the UK.

With sunny weather in short supply, the Chancellor tried to brighten everyone's day with some pre-election tax cuts – time will tell if those plans will entice voters come the General Election. However, it was the abolition of the 200-year-old non-domicile and remittance basis regime that got us hot and sweaty.

In this edition, we examine HMRC's enquiry and assessment powers, penalties, and the safeguards used to close the tax gap. Continuing with our series of looking at the origin of some of our tax rules, Stephen Yates offers his perspective on the history and background of the UK domicile rules – very apt at the moment. Jeremy Stein has penned an interesting piece on LLCs and HMRC practice, whilst Partner, William Watson, shares his experience of the day he and a group of colleagues walked between our London and Leatherhead offices in the name of charity.

As always, we hope you enjoy reading Tax Pulse and if you have any feedback or suggestions for future items, please direct your comments to the editorial team.

The Partners

Read this if you want to find out how HMRC exercises its powers to obtain taxpayer information, enforce the collection of and penalise those who fail to pay tax.

Based on published data from HMRC for the 2021/22 tax year, the tax gap (that is, the amount of tax not collected by the Revenue due to fraud, omission or error) currently stands at 4.8% of total theoretical tax liabilities or £35.8 billion. Over recent years, this deficit has been reduced across most taxes following improvements in the way HMRC collects and processes taxpayer data along with an increasing spotlight on targeting those who seek to avoid paying their fair share.

Given the recent changes announced by Jeremy Hunt in his Spring Budget, the implementation of which will be by no means inexpensive, continued efforts towards minimising the tax gap will be at the forefront of HMRC's objectives.

With the above in mind, this article will consider the means by which HMRC exercises its statutory powers to obtain taxpayer information, enforce the collection of tax and penalise those who deliberately or carelessly fail to pay their due.

Information gathering powers

Global information sharing between tax authorities has progressed significantly in the last decade via the Automatic Exchange of Information agreements enacted under the Common Reporting Standard. As a result, HMRC not only has access to a significant amount of a taxpayer's worldwide information, but also has broad powers to collect and share data relevant to the taxpayer's affairs.

HMRC will often first informally request information it requires from a taxpayer as part of a check into their tax affairs, though they have powers to issue formal information notices to obtain information and/or documents where the taxpayer is not cooperating sufficiently. In order to issue these notices, HMRC must be able to show sufficient connection between the intended recipient of the notice and the information sought.

Such notices can be issued to non-UK residents (including third parties) provided the information requested relates to a taxpayer's UK tax position. Any notice issued will specify the deadline for the provision of the requested information (usually 30 days, though this is dependent on the complexity and amount of information requested).

While HMRC is not restricted to asking for documents it can specifically identify, they cannot use these notices to 'fish' for information via broad, non-specific requests. Further, any requests must be factual in nature (i.e. they cannot request that the recipient of the notice provides a subjective opinion on matters). Nor can HMRC request documents that are not within the person's possession or power to obtain.

When requesting information from a third party via an information notice, HMRC may issue an informal notice initially. However, in practice they are likely to issue a formal notice in the first instance due to the data protection rules applicable to the recipients of such notices who are being asked to provide information about the taxpayer. In the event that HMRC wish to issue a third-party notice without approval from the taxpayer, without naming the taxpayer and/or without sending the taxpayer a copy

as is typically required (for example where they believe that doing so may prejudice the collection of tax) the First Tier Tribunal (FTT) must provide their prior approval. A third party may appeal against a notice which has been issued unless it has already been approved by the FTT, in which instance the only way of challenging the decision is via judicial review.

Daily penalties will apply where information notices are not complied with within the specified deadline, and separate penalties may be levied where information/documents are withheld, concealed or destroyed or where the information provided is inaccurate (though the amount of such penalties depends on the severity of the omission).

Under what circumstances can HMRC enquire into a tax return?

HMRC has the right to make enquiries into any tax return at any time within 12 months from submission of the return. For obvious errors or omissions HMRC can, within nine months of receiving a tax return, amend the tax return without opening an enquiry in order to correct these mistakes.

Where a taxpayer amends their tax return this commences a new enquiry window, though any such enquiry would be limited to matters to which the amendment relates. The timeframe for HMRC enquiring into an amendment is the next quarter day (i.e. 31 January, 30 April, 31 July or 31 October) following the 12-month anniversary of the day on which the amendment was made. Thus, for an amended return submitted on 28 February 2024, HMRC can enquire into the matters related to the amendment up to and including 30 April 2025.

Any enquiries made outside of the ordinary 12-month time limits can only be made via a discovery assessment (i.e. where loss of tax has been brought about carelessly or deliberately by the taxpayer or a person acting on their behalf, or there has been a failure to disclose all the relevant information). 'Carelessness' in this context is defined as a failure to take 'reasonable care' which must itself take into account a consideration of the particular person's abilities and circumstances. Therefore, taxpayers with more complex affairs, or professionals working in the tax industry, will be held to a higher expectation of 'reasonable care' than those taxpayers with very straightforward affairs.

Time limits for opening a discovery assessment

The time limit for HMRC to make a discovery assessment is ordinarily four years after the end of the tax year to which the assessment relates, though in cases where a taxpayer has been careless this is extended to six years.

For assessments relating to offshore matters concerning Income Tax, Capital Gains Tax or Inheritance Tax the time limit is 12 years. For serious cases where the loss of tax is brought about deliberately by the taxpayer or as a result of an anti-avoidance scheme the time limit is increased to 20 years.

It is important to note that, in addition to discovery time limits, the scope of penalties for inaccuracies leading to a loss of tax are similarly geared based on the severity of the behaviour giving rise to the understatement.

HMRC Codes of Practice 8 & 9 – civil investigation procedures

HMRC has two Codes of Practice which it can employ to open investigations where it suspects a significant loss of tax. A COP8 enquiry is most often opened where an individual has been involved in complex tax arrangements or offshore transactions, though this can be elevated to a higher level under COP9 where fraud is suspected or discovered during the investigation.

For cases of serious fraud, HMRC reserves the right to pursue a criminal investigation (see below) though may decide to investigate such cases via COP9. Under this civil procedure, the individual under investigation will enter a contract to make a complete and honest disclosure of all deliberate and non-deliberate behaviour via the Contractual Disclosure Facility (CDF). In return HMRC will agree not to pursue a criminal investigation (though will still levy penalties and interest for the underpaid tax).

As part of this process, the taxpayer must formally accept the CDF offer within 60 days of receipt, admitting any deliberate behaviour, must make a payment on account for the unpaid tax, and provide full details of all conduct, transactions and tax years relevant to the loss of tax in an initial outline disclosure to HMRC. This is then followed by a lengthy meeting between the Fraud Investigation Service (FIS), the taxpayer, and their adviser to discuss the issues outlined in the initial disclosure.

Following this meeting, the taxpayer, with the help of their adviser, will be invited to submit a full disclosure report which will often include a worldwide statement of assets and liabilities. Once the FIS has reviewed the report, comparing to data held by HMRC, they will issue a settlement offer covering tax, penalties and interest. As the CDF requires an admission of all deliberate behaviour, these tax-geared penalties can be significant (up to 100% of the tax due) and late-payment interest can equally be considerable (going back up to 20 years).

Any false or misleading information provided by the taxpayer as part of the CDF will result in HMRC withdrawing the offer and escalating the case to a criminal investigation. Equally, if the taxpayer is seen to be holding up the process without good reason for the delay, information notices may be issued to the taxpayer and third parties in order to collate relevant information that is being withheld and penalties will be increased as a result of the deliberate impediment to HMRC's enquiry.

Note also that taxpayers can submit a Form CDF1 to request COP9 for voluntary disclosure and protection from prosecution, though HMRC is not required to accept this. While protection from prosecution may be enticing to a taxpayer suspected of fraud, there are severe consequences to accepting a CDF via an admission of deliberate fraud (particularly where not all omissions or errors were deliberate) and care should be taken accordingly before any such decision is made. These consequences include the extension of HMRC's enquiry window to the maximum 20 years, the higher scope of penalties levied, the inclusion of the taxpayer's details on a published tax defaulter register, and greatly increased scrutiny from HMRC going forwards.

HMRC's criminal powers

The recent 2023/24 Finance Bill saw the maximum sentence for criminal penalties applied in cases of fraud increased from seven to 14 years, reflecting the seriousness of such offences in the eyes of the law. When seeking to uphold the law insofar as it applies to HMRC-related offences, HMRC has similar criminal investigative powers to other UK law enforcement agencies. These powers include the power to:

- Apply for orders requesting the production of certain information (these must be issued by a Magistrate or Judge).
- Apply for and execute search warrants.
- Make arrests (HMRC has in its employ approximately 1,500 officers with the power of arrest).
- Search suspects and premises following arrest.
- Recover criminal assets through the Proceeds of Crime Act 2002.

There are numerous safeguards designed to ensure that these powers are only used by those authorised to do so and only in permitted circumstances.

For serious crime, HMRC can apply to use intrusive surveillance powers such as the interception of communications, though any such request must be justified, necessary and proportional in line with the European Convention on Human Rights and must be authorised by the Home Secretary and a Judicial Commissioner.

Please speak to your usual R&H contact if you wish to discuss any aspect of this note.

DOMICILE AND THE REMITTANCE BASIS - A BRIEF HISTORY

Read this for a potted history of UK domicile rules and what the Government's March announcement means.

Domicile made the headlines recently, when the March 2024 Budget announced the abolition of the remittance basis taxation from 6 April 2025. Substantial reform of the tax legislation will be needed, and until we see the new rules, and the outcome of the General Election is known, significant areas of uncertainty remain.

In UK law, a person's domicile is the place of the legal system or jurisdiction they are most closely connected with. It can be considered as their true home. You can have only one domicile at any given time. The rules for determining where that domicile is have been developed in case law dating back to the 1800s. A legitimate child born during their father's lifetime will take the domicile of the father as a domicile of origin, otherwise it is the mother's domicile. The domicile of a minor usually follows that of the parent on whom they are legally dependent. From age 16, a new domicile of choice can be adopted by moving to a new jurisdiction, with the intention of having the sole or main residence there permanently or indefinitely, although there is a relatively high bar to establish this.

Case law has held that an individual had adopted a domicile of choice in the UK, after an extended stay of nearly 50 years here, with no real plans to return to the domicile of origin. In addition, from 1974, the legislation has treated long term UK residents as deemed UK domiciled for inheritance tax purposes; from 6 April 2017 this deeming extending to income tax, capital gains tax and inheritance tax, once an individual has been resident for 15 out of the last 20 tax years.

Currently, and up to 5 April 2025, individuals who are not domiciled, nor deemed domiciled, in the UK can claim the remittance basis of taxation. This means that they only pay tax on foreign income or gains to the extent that they are remitted, which broadly speaking means brought to or used in the UK. Income or gains which arise in the UK are taxable in any event.

But the remittance basis has not always been restricted to foreign domiciled individuals. Until 1914, all foreign income was taxed on the remittance basis (and gains were not taxed at all, until the introduction of capital gains tax in 1965). Since 1914, the availability of the remittance basis has been reduced in stages, except for foreign domiciliaries. Until 1974, UK domiciliaries had the remittance basis for income from offshore trades, employments and pensions. This general remittance basis was abolished in 1974. The same rules applied to companies until 1965, when arising basis corporate taxation was introduced.

As noted, from 6 April 2025 the remittance basis will be abolished: all foreign domiciliaries will be taxed on the arising basis, subject to some transitional reliefs. But not all the detail of the new regime

is clear. We do not yet have draft legislation for the proposals, and the Labour Party has said that, if they form the next government, they will modify the measures.

Domicile will continue to be relevant in one non-tax area, succession law. This could be relevant if you are domiciled in a country where forced heirship rules prescribe who inherits your estate. Alternatively, if you are domiciled in the UK on death, dependents can apply to the Court for a share of your estate, if your will does not make reasonable provision for them.

In tax, domicile will also continue to have an impact. For individuals who have previously used the remittance basis, unremitted foreign income and gains will continue to be taxable on future remittance after 5 April 2025. And the inheritance tax treatment of trusts at present depends on the domicile of the settlor who created them. This will continue for at least some trusts created before 6 April 2025, so that the domicile of the settlor will continue to be relevant for the remainder of the lifetime of the trust, potentially around a hundred years or so. Finally, domicile will continue to be relevant for the ten inheritance tax treaties the UK has with individual countries.

So the concept of domicile is not yet dead!

Please speak to your usual R&H contact if you wish to discuss any aspect of this note.

UK RESIDENTS WITH INTERESTS IN US LIMITED LIABILITY COMPANIES (LLCS)

Read this if you want to learn about HMRC's current stance on income and capital gains from US Limited Liability Companies.

As UK tax advisers, we often have to consider the personal tax implications of clients who have an interest in a US Limited Liability Company (LLC). (N.B. A number of other countries operate LLC structures but due to their hybrid treatment in the US, US LLCs present particular issues in the UK).

HMRC recently published revised guidance of its view on the UK tax treatment of US LLCs.

This is a brief overview of the current position and HMRC's revised views. But first, some background.

What is a US Limited Liability Company

An LLC is a common US business structure allowed by US state statutes, although the precise state regulations may vary. LLC owners are called members. Most states do not restrict ownership, so members may be individuals, corporations, other LLCs or foreign entities. There is no maximum number of members and most states permit a "single member" LLC, having only one owner.

LLCs are used for a variety of business purposes including holding US real estate, or other investments, or as a trading entity.

An LLC is an entity separate from its owners with its own rights, responsibilities and liabilities. An LLC can buy, own and use its own property, make its own contracts and guarantees, lend money and invest funds. It can also file a lawsuit or be sued. Because it is a separate legal entity, the LLC's owners have limited liability i.e. the individual assets of the LLC's members cannot be used to satisfy the LLC's debts and obligations. Limited liability is a key advantage of this type of business structure.

How does the US treat an LLC?

If a special election has been made by the LLC it will be treated as a corporation. If not, it will be treated by the US Internal Revenue Service (IRS) as a partnership or as a "disregarded entity" i.e. with the profits and gains forming part of the individual owner's US tax return. A US LLC with at least two members is classified as a partnership for US federal income tax purposes.

How is an LLC taxed in the UK?

The default US position, that an LLC with at least two members is regarded as a partnership for US federal income tax purposes, can result in complications for UK residents having interests in US LLCs; including a mismatch in the US and UK tax treatment, potentially leading to double taxation.

HMRC's long-held view is that US LLCs should generally be treated as opaque entities for UK tax purposes i.e. as companies. Hence ordinary distributions received by UK resident individuals from US LLCs should be treated as dividends, taxable at current income tax rates of up to 39.35%.

A foreign tax credit may be available on such dividends but the position is far from certain despite the fact that the LLC member is generally the person taxed on any profits of the LLC as they arise. Similarly, if an LLC interest is sold, disposed of by way of a gift or wound up, ordinarily the disposal should have UK capital gains tax treatment, with any sterling gain taxable, at current rates of up to 20%.

Hence, UK residents with US LLC interests can suffer at least two layers of taxation; US federal (and possibly state) income tax on their share of the LLC's underlying profits, and UK income or capital gains tax on LLC distributions. Furthermore, UK tax relief for US tax suffered may not be available, meaning that the double tax suffered in the UK and US can be up to both top marginal tax rates (i.e. 37% federal tax in the US and 45%/39.35% in the UK). This is worse than if the LLC was regarded as a company in the US and paid regular US corporation tax (currently 21%).

The Anson case

The UK treatment of a US LLC and availability of foreign tax relief was considered by the Supreme Court in the context of a Delaware LLC in the key case of *Anson v Revenue & Customs* [2015] UK SC 44. The issue for the court was whether the UK tax payable by Mr Anson should be computed by reference to the same income or profits as those upon which his share of the LLC's profits had suffered US tax. Mr Anson was a UK resident but non-UK domiciled individual so the issue was relevant only to his share of LLC profits which had been remitted to the UK.

Agreeing with the First Tier Tribunal's (FTT) finding of fact based on the Delaware LLC Act and the LLC operating agreement, the Supreme Court found that the member's share of the LLC's profits was his for UK income tax purposes, and not the amounts distributed to him. In other words, Mr Anson was entitled to the share of the LLC's profits allocated to him, rather than receiving a transfer of profits previously vested in the LLC.

Hence, the income which was taxed in the US was Mr Anson's share of profits and his UK liability should be computed accordingly i.e. on his share of LLC profits remitted to the UK. Mr Anson, therefore, qualified for foreign tax relief on the US tax he suffered on his share of the LLC's underlying profits as the income taxed in both jurisdictions was the same.

Significantly, the FTT's finding of fact was also that the member's interest in the LLC was not akin to share capital but was closer to partnership capital in an English partnership. Note, however, this ruling was not explicitly saying that the LLC 'was' a partnership for UK tax purposes.

HMRC's response to Anson

HMRC's immediate response to the Anson case back in 2015 was that they considered the decision to be specific to the facts of the case; and that it would continue its existing approach to determine whether a US LLC should be regarded as issuing share capital. HMRC stated their view that LLCs would still be regarded as US corporations and also stated that any individuals claiming double tax relief and relying on the Anson decision would "be considered on a case by case basis".

Recent HMRC guidance on US LLCs

HMRC have recently hardened their view on the UK tax treatment of US LLCs, a position that appears to be due to HMRC having received new legal advice on the implications of Delaware LLC law, and the LLC law of other US states.

In their latest December 2023 guidance, based on HMRC's understanding of Delaware LLC law, and contrary to the conclusion of fact reached by the FTT in the Anson case, HMRC state that they continue to believe that the profits of an LLC will generally belong to the LLC in the first instance and that members will generally not be treated as "receiving or entitled to the profits of an LLC".

HMRC's re-stated general view is, therefore, that individual LLC members will only be liable to UK tax on LLC distributions. If the LLC is treated as a partnership (or is disregarded) for US tax purposes, HMRC's view is that no double tax relief will be available in the UK.

The position may be different if the LLC is treated as a corporation for US tax purposes.

Moreover, contrary to the FTT's finding of fact in the Anson case, HMRC's current view is that an LLC member's capital account is fundamentally no different to the concept of share capital, reinforcing HMRC's general approach to treat US LLCs as companies for UK tax purposes.

Where does this leave UK residents with interests in US LLCs?

For the majority of UK residents having interests in US LLCs, the pragmatic approach is likely to be to accord with HMRC's long-held published view and to treat LLCs as companies for UK tax purposes. However, in specific circumstances, particularly where the facts of the case closely align with the Anson case, there may still be reasonable arguments to treat an LLC as a transparent entity for UK tax purposes in respect of its income, for example, for the purpose of claiming foreign tax credit relief. This might help to avoid the potentially penal rates of double taxation.

The tax treatment of US LLCs is a complex area. Specialist UK/US tax advice is required. Work and research will be required in considering the specific US state LLC law, the deed of the LLC itself and how the entity operates, as well as the nature of any distribution from the LLC i.e. whether it is a dividend, or a dividend like distribution, or a partial or full liquidation distribution etc.

Please speak to your usual R&H contact if you wish to discuss any aspect of this note.

A GENTLE STROLL THEY TOLD ME

Read this to discover how a group of colleagues got on with a daunting charity walk.

A Roman legion would typically march 20 miles in a day – why did we decide to do more?

As part of the Firm's 90th anniversary celebrations, we wanted to mark the event by raising money for the Royal Marden Cancer Charity, our employee nominated charity, by walking between our two offices.

Braving the mud!

Google Maps informed me the quickest route between our London and Leatherhead offices was 19.8 miles long and would take some 7 hours 24 minutes. Us accountants and tax advisers are, on the main, a sedentary bunch and as such, 19.8 miles represents quite a daunting challenge. No doubt there are some reading this who routinely run half marathons or longer, to which I stand (sit) in awe.

However, the route Google Maps suggested would mean walking from Clapham Common to Leatherhead along the A24. It may be the shortest, but it would not be the most picturesque or healthiest route. Alex Jones, who spearheaded the initiative and a keen walker, set about creating his own course.

The new route meant we would be walking along the Thames Path, through Putney Heath and Richmond Park, before following the Hogsmill River and over Ashtead Common. All very pleasant.

The drawback to all this beauty was a longer route of 25.5 miles. Let's round that up to up, 26 miles, or 1 London Marathon, and perhaps would be even further if my navigational skills were not up to scratch.

Nevertheless, at 08:30 on 22 March, 23 of us, comprising all departments of the Firm and all grades from school leaver trainees through to Partner, departed New Street Square under grey skies with a spring in our step and a nervous glance or two at the heavens. I should also mention that some of us might have been feeling a little tender from giving Andrew Shilling a proper send off the night before.

A little over 9 miles in and, having made good progress aside from a minor navigational error around Battersea, the heavens opened during our first scheduled stop. With the legs already feeling the strain, it is was at this point you begin to question the whole walk.

However, with a great bunch of walkers around me we ploughed on and thankfully, by the time we were trundling through Richmond Park, the rain had ceased and we were experiencing perfect walking conditions.

As we got further into the walk, all the rain we had experienced over the winter had made some stretches of the Hogsmill River trail more akin to a swamp. Great fun, but not everyone's shoes remained on.

A round of blister packs, an injured ankle, a few muddy socks and some ibuprofen later, a bedraggled crew arrived at Randalls Way, Leatherhead around 6pm. Despite being greeted by a beautiful sunset, pizza, refreshments and the support crew, I was utterly exhausted and adamant I would not do it

again.

Fast forward a month, and with a return fixture planned for next year, it is not a 'No, I will not attend', but perhaps more of a 'Tentative, maybe'. Will that turn into a definite 'Yes', who knows?

There are several people I would like to thank for getting me through the day. Firstly, to Alex Jones who, despite injuring his foot severely during a practice walk and was unable to take part, provided a 4-page set of route instructions.

I was fairly confident that navigation was not going to be an issue, being armed with a map and a phone. However, what I did not consider was the impact fatigue would have. There were times when these instructions were invaluable and the walk would not have taken place, or be the success it was on the day, without him.

Secondly, my gratitude goes out to those who have sponsored us. Currently, £8,864 (net of gift aid) has been raised, and the sponsorship page is still open **www.justgiving.com/page/rawlinsonandhunterl2l**

Finally, a thank you also to my fellow walkers on the day who helped raise the money and provided great conversation for over 9 hours – you are all tremendous.

Our first stop

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