The Offshore Tax Planning Review

SCHEDULE E AND OVERSEAS ACCOMMODATION

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It is a familiar story: Pile-it-High Stores Ltd (a UK company) has had a good year. It buys a house in Florida for the sterling equivalent of £175,000. The Chairman spends six weeks in each year of assessment in the house rent free. At other times it is available for his use. For each of the years in question he is assessed under section 145 of the Taxes Act on an amount equal to the "annual value" of the house, and under section 146 on the "appropriate percentage" of the excess of cost over £75,000. "Annual value" is taken to be the commercial rent for a year's lease of the property unfurnished (say £15,000 p.a.). If the property were in the UK, annual value would be based on the now obsolete rateable value of the property (say £600), section 146 having been enacted to make up for the loss of tax represented by that measure of value. The purpose of this article is to discuss two issues: first do ss.145 and 146 really have any application to overseas properties? Second, if they do, can the use of a different measure of annual value be challenged?

Annual Value: Schedule E Manual

The Revenue's Schedule E manual is very clear on the subject of annual value:

"*2239 Annual value: United Kingdom properties*

[Ss. 145(2) and 837 ICTA 1988]

"Annual Value" is defined in section 837 ICTA 1988 as:

> " the rent which might reasonably be expected to be obtained on a letting from year to year if the tenant undertook to pay all usual tenant's rates and taxes and if the landlord undertook to bear the costs of the repairs and

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insurance and other expenses, if any, necessary for maintaining the subject of the valuation in a state to command that rent".

Gross rating value of United Kingdom properties is taken as the equivalent of "annual value" for tax purposes because the definition in section 837 is similar to that used in section 19(b) General Rate Act 1967 and its use avoids annual revaluations to arrive at current rental value.

The higher values produced by the 1985 rating revaluation in Scotland are not adopted for tax purposes because using them would be unfair in view of the lower values produced by earlier revaluations elsewhere in the United Kingdom.

You can find the gross rating value of any property for which one has been set, whenever built, using the table above. If a property was built after the last rating revaluation the gross rating value which it is given is the same as the value it would have been given had it existed at the time of that revaluation".

"*2244 Annual value: property outside the United Kingdom*

The annual value of property as determined for any rates or taxes in countries outside the United Kingdom is not for that reason on its own an acceptable measure for United Kingdom tax purposes. The annual value of living accommodation outside the United Kingdom should therefore be determined in accordance with the definition in section 837 ICTA 1988 (see SE2239).

Ask the employer or the person providing the accommodation to give a full description of the accommodation and locality (accompanied, where appropriate, by photographs) and an estimate of the annual rent at which it could be let for a year unfurnished on the assumption that:

- the tenant met all the customary tenant's burdens; and
- the landlord met the cost of repairs insurance and other landlord expenses.

He will normally be able to obtain an estimate from a local estate agent in the country concerned".

A point to note here is the reason given for using the old rating figures for Scotland[2], namely the "unfairness" that would otherwise be created as between taxpayers in different parts of the country. This is material to the second issue to be discussed of whether (assuming section 145 to be applicable) the refusal of a corresponding concession to taxpayers using overseas properties is lawful.

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[2] See ESC A56.

Annual Value: A Territorial Limitation?

The definition of annual value (in s.837 ICTA 1988) is as follows:

(1) For the purposes of, and subject to, the provisions of the Tax Acts which apply this section, the annual value of land shall be taken to be the rent which might reasonably be expected to be obtained on a letting from year to year if the tenant undertook to pay all usual tenant's rates and taxes, and if the landlord undertook to bear the costs of the repairs and insurance, and the other expenses, if any, necessary for maintaining the subject of the valuation in a state to command that rent.

(2) Section 23 of the General Rate Act 1967 (adjustment of gross value by reference to the provision of or payment for services etc) shall apply for the purpose of subsection (1) above, and in relation to land in Scotland or Northern Ireland shall apply as if it extended to the whole of the United Kingdom.

(3) Where any question arises as to the annual value of land it shall be determined by the General Commissioners and those Commissioners shall hear and determine the question in like manner as an appeal.

The reader is asked to reflect on the implications of subsection (2). The notional extension of section 27 of the General Rate Act to the "whole of the United Kingdom" for the purposes of subsection (1) raises the clearest possible inference that subsection (1) is limited to land in the UK. When one traces section 837 to its statutory source, namely, the Finance Act 1963, that inference is conclusively confirmed by the original version of subsection (3) which referred not just to "the General Commissioners" but to "the General Commissioners for the division in which the land is situate".[3] It is important to understand that this is not a procedural point.[4] The argument here is that, as a matter of construction, s.837(1) applies only to UK land because:

(a) subsection (2) is intelligible only on that basis;

(b) the history of s.837 shows that, when first enacted, the inference created by subsection (2) was specifically confirmed by the jurisdiction provision in FA 1963 s.30, and the meaning to be given to subsections (1) and (2) cannot have altered by the process of consolidation and re-enactment.

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3 FA 1963 s.30.

4 TMA 1970 Schedule 3 para 4 still gives jurisdiction to the Commissioners for the place where the land is situate, but there is now a general power given to the Board to make directions where the rules for assigning proceedings to Commissioners would give a place outside the UK: F(No 2)A 1975 s.66(4).

Hansard confirms this interpretation to have been the understanding of Ministers. In the course of the debates on the Finance Bill, and after noting that the definition of annual value applied both for the purposes of Schedule A and Schedule E,[5] Mr Barber said:

> " In determining annual values for the purposes of the Bill the inspector of taxes and the general commissioners for the division in which the land is situated, who under Clause 30 constitute the appellate body in the appeal, will apply the principles laid down by English law for the determination of rating assessments, but they will not be bound by the figure in the rating valuation list, which will necessarily have been arrived at on the facts of a year earlier than the year to which the Income Tax assessment relates.
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> [As to] the change in the law as it applies to Scotland in [s.837(2)]. Although rating law, as I understand it, in Scotland and in Northern Ireland, which is also referred to, differs in certain respects from rating law in England, the principles for determining income values will be the same throughout the United Kingdom".[6]

Consequences of the Territorial Limitation

Section 145 operates through the definition of annual value in section 837: see subsection (2). Accordingly, if it is correct to say that section 837 has no application to overseas properties, then likewise section 145 has no such application. As to section 146, this operates through section 145 (subsection (1)(b)), so this too fails to bite.

Reviewable Discrimination?

It will be recalled in para 2244 of the Revenue's manual, it is stated in terms that no concession is given in arriving at the annual value of overseas property. If the main thesis of this article is incorrect and section 145 is applicable to such property, is this difference in treatment open to review? Two concessions are in operation for UK property. First, as will be seen from *Hansard* extracts, it was never envisaged that the Revenue would be tied to the valuation lists (i.e., annual value could be reassessed as often as required), but in practice the old valuations are used (or equivalent figures arrived at for new properties). Second, as respects

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5 Vol 677 cl 1658. Social historians should be aware that the same volume contains an exchange on the subject of one "*Marilyn* Rice-Davis".

6 Cls 1663/1664.

Scotland where a revaluation was made in 1985, there is, as mentioned, an ESC under which the 1978 valuations continue to be applied (so as to avoid "unfairness"). Your contributor is amazed that against this background, the Revenue insist that commercial rents provide the only acceptable basis of measuring the annual value of overseas properties. This is so clearly irrational, unfair and an abuse of power that it surely would not stand up to review in the High Court. But first the appellate procedures on the territorial limitation point would have to be exhausted. A daunting prospect!