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Personal Tax

Dispensation claims before the year-end

Introduction

It is well known that obtaining a dispensation is worthwhile for all concerned, so that the item covered is not included on form P11D and consequently the employee does not include it on his own tax return.

There are two main conditions applying for success:

1. no tax would be payable by the employee on the expense paid or benefit provided; and
2. expense claims should usually be supported by receipts, and be independently checked and authorised within the business

HMRC *Employment Income Manual para 30061* says that a voucher will not be required *"for trifling expenditure, such as small allowances for taxis fares"*.

In deciding which items to include in a dispensation claim, it should be appreciated that there are several which are in any event tax-exempt by statute or HMRC practice, as under.

Exempt benefits

- Annual parties or similar functions – Section 264 ITEPA2003
- Job-related living accommodation – Sections 98 & 101
- Long service awards – Section 323
- Medical treatment abroad – Section 325
- Parking places at or near employee's place of work – Section 237
- Relocation expenses and benefits – Part 4, Chapter 7
- Late-night journeys home – Section 248
- Incidental overnight expenses – Section 240
- Authorised mileage allowances – Sections 229 to 234

HMRC practice where no need to report

These include:

- Purchases on employer's behalf (e.g. stamps, stationery) - Chapter 5 of booklet 480
- Periodic medical check-ups and eye tests for employees using VDUs – *Employment Income Manual para 21765*
- Trivial benefits provided, with examples such as a seasonal gift; (turkey; an ordinary bottle of wine; or box of chocolates – *Employment Income Manual paras 21860 to 21863* with *EIM21863* implying that 2 bottles of wine may be acceptable but not a case.

Business entertaining

The distinction between business and staff entertaining is important for several reasons, including a dispensation. The *Employment Income Manual para 30077* says that they will normally regard the following as reasonable and genuine business occasions which can be covered by a dispensation:

- Genuine product launches
- Lunches for customers or potential customers, at which business is discussed
- Reasonable entertaining at exhibitions

Controlling directors

HMRC encourage dispensations. As the expense claims must be independently checked and authorised this could ordinarily stop some directors from being included. However in *para 30059* of *Employment Income Manual* it says they will consider a dispensation for controlling directors provided that:

- They are independently vouched: and
- They are allowable as a deduction from earnings (e.g business travel and subsistence); and
- The Inspector is satisfied that no tax is at risk

Applying for a dispensation

Form P11DX can be used, to include details of expenses; benefits; the employees to be covered; and details of the employer's authorisation policy. Under *para 30052* of the *Employment Income Manual*, a dispensation can be backdated to the start of the tax year of application

Para EIM30083 says that where expense items within a dispensation are set at a particular amount, that can be uprated annually by the employer without the need to obtain HMRC's agreement, provided it is no more than the RPI increase.

Using a dispensation application to determine HMRC view on certain expenses

There are often genuine doubts as to whether or not an expense incurred by the employer constitutes a taxable benefit. For example, where training costs are really a reward for services or an inducement to continue in employment, as opposed to a means of providing knowledge likely to be useful to the employee in his employment. The latter would not be a problem, but if there is doubt as to whether the requirements are met it should be possible to obtain HMRC's view by applying for a dispensation (or variation to an existing dispensation) to include training costs. If it is granted, all well and good providing of course that the business aspect can be justified. If a dispensation is not granted, on the grounds that the training costs could give rise to an income tax charge, the employer and the employee know where they stand and may decide not to proceed with the expense.

Revoking a dispensation

HMRC practice has been to consider revoking a dispensation retrospectively only in exceptional circumstances. In *Employer's Bulletin February 2008* they say that legal advice obtained means that their practice is unnecessarily restrictive and as a result they are changing it. Specifically, they will consider revoking a dispensation retrospectively where there is any evidence of misrepresentation or negligence by an employer, or other person paying expenses or providing benefits in kind. They give the following two separate examples of this:

1. An application for a dispensation did not provide all the relevant information.
2. There was a change in the way the expenses and benefits were made available to employees, meaning that the qualifying conditions were no longer met but HMRC have not been informed of the change.

Article by Gerry Hart
Lecture P521 (8.56 Minutes)

The attractions of rent-a-room relief

Those who are seeking to increase income during the current credit crunch might well consider the rent-a-room scheme, which can yield annual tax-free income of £4,250.

Law and practice

The following are useful sources of information:

- ITTOIA 2005, Chapter 1 of Part 7, s 309, and ss 784 to 802.
- HMRC *Property Income Manual* at PIM 4001 to PIM 4060.
- HMRC *Help Sheet 223*

The principle

A householder taxpayer, not companies or partnerships, may receive rent of up to £4,250 a year tax-free by letting a room on a ***residential basis*** in their ***main*** residence.

This rent may or may not include additional services such as food, cleaning and laundry.

It applies to the ***main*** residence of the individual or individuals and includes rented accommodation provided the lease allows the taxpayer to take in a lodger, and his insurance company is content.

Relief can be granted for accommodation in a:

- Caravan
- Houseboat
- Self-contained flat in the residence, provided conversion to a flat is temporary
- Guest house or bed and breakfast operation in some instances.

Moving house

Where the qualifying individual moves to a new home, leaving a lodger in occupation, the old property will continue to be eligible for rent-a-room relief until the end of the basis period during which the qualifying individual moved.

The relief

Gross receipts of up to £4,250 in a tax year are earned tax free but there no deduction for expenses.

The £4,250 limit is per property and so where a property is owned jointly, the amount is split between them.

Where the rent exceeds £4,250 a year, the taxpayer has a choice:

- Be taxed on excess of rental income over £4,250
- Elect for the normal basis for the taxation of a furnished letting to be adopted

Rent a room v normal basis

The option for electing for the normal basis of assessment exists in any case, and this needs to be considered on an annual and case-by-case basis.

Losses cannot be created under the rent-a-room scheme.

However, losses brought forward from previous furnished letting assessments may only be set against the assessable amount in excess of £4,250 or furnished lettings assessment generally, where that method is adopted.

Claims, elections and time limits

Claims are made on the self-assessment tax return (Property income supplementary pages).

HMRC's Property Income Manual at PIM4050 sets out details of time-limits and elections.

The election for the exemption not to apply must be in writing to an officer of HMRC. Making the appropriate entries on the self-assessment return will suffice. The election covers one year only.

The time-limit is one year from 31 January following the year of assessment. For the tax year 2008-09 this would be 31 January 2011. The election may be withdrawn within the same period.

A similar election is required, with the same time-limits, where the rent-a-room profits are calculated on the basis of the total gross rent receipts for the year less £4,250.

This election continues in force for subsequent years until withdrawn, either by reduction of rent below £4,250 or adoption of a furnished lettings computation in the tax return. Once again the election may be withdrawn before one year from 31 January following the year of assessment.

HMRC will normally extend the time-limits in cases involving sickness or absence abroad by the taxpayer, other serious personal difficulties, and other situations where the delay in electing occurred through no failure by the taxpayer or his or her advisers, e.g. the election getting lost in the post.

Qualifying room

The residence in which a room is let must be the only or main residence at some time during the basis period. It may not necessarily be the main residence for CGT purposes.

However, it should be the place where friends and correspondents would expect to find the taxpayer.

Moving abroad

Relief is no longer available when the taxpayer moves abroad, as the home then ceases to be the main residence.

However, PIM4010 confirms that relief would continue to be available until the end of the year of assessment when the taxpayer emigrated. If he returns home during a period abroad when the property continues to be the main residence, rent-a-room relief may be due for that tax year.

Where the taxpayer moves home during the year, and lettings continue in both old and new properties, eligibility for relief continues.

Guest houses and B&Bs

PIM4010 confirms that where the taxpayer runs a guest house or bed and breakfast business and the operation amounts to a trade, rent-a-room relief may still be claimed.

However, the taxpayer should exclude any taxable profits from the rental business and return them as trading profits.

If the taxpayer has two or more rent-a-room sources in the same residence: for example, income from a lodger and trading income from a bed and breakfast business, the rent-a-room rules must be applied to all sources within the residence, because it is immaterial whether the rent-a-room receipts are treated for tax purposes as derived from one source or from two or more separate sources.

If the taxpayer has an unfurnished letting as well as a furnished letting within the residence, he is not a qualifying individual. Where a guest house business is conducted partly from the individual's main residence and partly from another property or properties, and on the facts of the case all rents constitute one source of income, then rent-a-room relief cannot apply.

Where more than one person lets at the same time, the annual relief is divided. *Property Income Manual* at PIM 4010 gives the example of three sisters who each let a room in a home owned by one of them.

Only one is a qualifying individual, and she is eligible to a reduced allowance of £2,125. The other sisters are assessable to tax under the property income legislation. If all three sisters were qualifying individuals, each would receive an allowance of £2,125 which exceeds the £4,250 limit available.

From an article by John Newth writing in Taxation, February 2009

Lecture P522 (8.33 Minutes)

Burns v HMRC and the motive defence

The recent case of *Burns v HMRC* (SpC 728) deals with an important issue that often causes dispute; i.e. whether the 'non tax avoidance' defence (the motive defence) is available to prevent liability under the transfer of asset provisions of ITA 2007, s 720 (formerly TA 1998, s 739).

The facts

The basic facts can be shortly stated as follows.

1. The taxpayers – described as having 'an absolute dedication to horses and equestrian pursuits' – became entitled to an industrial estate in the UK at the tender age of 18.
2. Each appellant immediately transferred the estate to a Jersey company wholly owned by her. We refer to this as 'the transfers'.
3. The taxpayers were at that time (1980 and 1982) resident and domiciled in Jersey.

The issue

The taxpayers subsequently became UK resident. They would be subject to tax on the income of the Jersey companies under (what was then) TA 1988, s 739 unless (what was then) TA 1988, s 741 applied.

Section 741 applies if:

> (a) the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected; or (b) the transfer and any associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation.

The provisions are now in ITA 2007, ss 736 to 742, but the essential points of the defence remain the same.

The taxpayers argued that the conditions in s 741(a) and 741(b) above were both satisfied. The case therefore raised three issues.

- Was the purpose of avoiding liability to taxation one of the purposes for which the transfers were effected?
- Were the transfers commercial transactions?
- If the transfers were commercial transactions, were they designed for the purpose of avoiding liability to taxation?

The subjective approach

The taxpayers were only 18 years old at the time of the transfers and executed the documents because their parents asked them to so. The Commissioners looked to the parents' reasons for asking their daughters to carry out the transactions.

The taxpayers argued that it was to separate the management and ownership of the industrial estate for the benefit of the estate and the taxpayers. Unfortunately for the taxpayers, the Special Commissioner did not accept this.

The tax background

HMRC identified two tax advantages of the transfers:

1. The income tax advantage

The taxpayers (even though not resident in the UK) would have been liable to higher rate tax on the UK source rental income from the UK properties if the arrangements to transfer properties into Jersey companies had not been taken. As a consequence of the transfers, the companies received and were liable to tax in respect of the rental income from the settled property. They paid only basic rate tax on the income.

The basic rate of tax paid by the companies was lower than the higher tax rates that would have applied to the individuals.

2. The CTT/IHT advantage

The capital transfer tax (CTT) advantage alleged was that UK property directly owned by an individual would form part of his or her estate, wherever he or she was domiciled or resident.

If the property was held by a non-UK company, assuming the individual who owned the company's shares was domiciled outside the UK, the shares would be excluded property, outside the scope of capital transfer tax. The same applies now, of course, for inheritance tax (IHT).

There were indeed capital transfer tax benefits from the transfer.

The Special Commissioner concluded that he was not persuaded that UK tax advantages were not amongst the purposes sought by the parents of the taxpayers in planning the transfers, and so by the taxpayers when they followed their parents' wishes and effected the transactions.

Avoidance/mitigation distinction

The Special Commissioner accepted that if he considered that some taxation purpose was sought to be achieved by those initiating the transactions, he must go on to address 'the difficult task of

distinguishing between tax avoidance and tax mitigation, only the former being fatal to the s 741 defence'.

For both the income tax and CTT advantage he concluded that it was tax avoidance.

The Special Commissioner's view in relation to the capital transfer tax advantage is more contentious. He stated:

> 'I would certainly accept that if a non-domiciled person arranged to hold foreign situs, rather than UK situs, assets, and then died, no tax advantage would have been sought. Thus if a UK house was sold, and a French house purchased, that would simply be a case of genuinely changing the assets held, and were some s 739 point to hinge on whether the change was effected for the purpose of avoiding UK tax, the answer would be that it was not. And if UK bank deposits were withdrawn and deposits placed elsewhere, then again, that would be a pure investment switch, and not a step the purpose of which would involve the purpose of achieving a UK tax advantage.'

This is clearly in line with *Beneficiary v CIR* [1999] SSCD 134 (SpC 190). He went on, however:

> 'Indirectly retaining a UK real property, and simply achieving the technical change in status by putting the property into a non-UK resident company in a case where one of the purposes is to achieve the potential inheritance tax advantage, implicit by effecting those steps, does seem to me to cross the border between mitigation and tax avoidance. This is because it has involved no real change of investment, as in the two previous examples, but the retention of the UK property, accompanied by a step to change the normal tax consequences of that. Thus where it is shown that the capital transfer tax or inheritance tax considerations were one of the purposes of the transfer, or rather where the appellants have not displaced the reasonable presumption that UK advantages were one of the purposes, I conclude that those purposes involve tax avoidance and not merely mitigation.'

The reasoning here is questionable and may well come back to the tax tribunal.

From an article by James Kessler QC and Amanda Hardy writing in Taxation, February 2009

Lecture P523 (10.06 Minutes)

Patel v Marquette Partners (UK) Ltd

Section 13 of the Employment Rights Act 1996, so far as material, provides: '(1) An employer shall not make a deduction from wages of a worker employed by him unless - (a) the deduction is required or authorised to be made by virtue of a statutory provision or a relevant provision of the worker's contract, or (b) the worker has previously signified in writing his agreement or consent to the making of the deduction.'

Section 14 of the Employment Rights Act 1996, so far as material, provides: '(3) Section 13 does not apply to a deduction from a worker's wages made by his employer in pursuance of a requirement imposed on the employer by a statutory provision to deduct and pay over to a public authority amounts determined by that authority as being due to it from the worker if the deduction is made in accordance with the relevant determination of that authority.'

Regulation 80 of the Income Tax (Pay As You Earn) Regulations 2003, SI 2003/2682, so far as material, provides: '(1) This regulation applies if it appears to [HMRC] that there may be tax payable for a tax year under regulation 68 by an employer which has neither been - (a) paid to [HMRC], nor (b) certified by [HMRC] under regulation 76, 77, 78 or 79. (2) [HMRC] may determine the amount of that tax to the best of their judgment, and serve notice of their determination on the employer.'

In November 2001, the employee started work as a trader for the employer. In addition to basic pay, the employer paid the employee a bonus in December of each year. In the tax years 2002/2003 and 2003/2004, the employee received bonus payments by way of dividends on shares which were distributed through an 'employee benefit trust'. The trust was a recognised scheme which was set up in certain sectors of commerce to, inter alia, assist employers minimise their tax liability. Despite the perceived benefits of the trust scheme, in December 2006, an officer of Revenue and Customs informed the employer that the dividends which it had paid to the

employee were 'earnings' for tax purposes, and, as such, additional liability arose under the Income Tax (Pay As You Earn) Regulations 2003, SI 2003/2682 (the Regulations). No determination under reg 80(2) of the Regulations was made when, in either December 2006 or January 2007, a sum representing approximately £65,000 was withheld from the employee's entitlement to bonus for the relevant year. An internal complaint was made by way of a grievance letter, however, in due course, the employee left his employment with the employer and commenced proceedings in the employment tribunal. One of the issues before the tribunal was whether it had jurisdiction to entertain a complaint which had been made by the employee, namely whether the deduction in question was unauthorised, having regard to ss 13(1) and 14(3) of the Employment Rights Act 1996 (the 1996 Act). The tribunal held that it had no jurisdiction to hear the issue. The employee appealed against that ruling.

The employee contended that the tribunal could have had determined the lawfulness of the deduction in question under s 13(1) of the 1996 Act, on the ground that the same was not within the category of an 'excepted deduction' under s 14(3). The employer argued, by reference to, inter alia, s 8 of the Social Security Contributions (Transfer of Functions, etc) Act 1999 (concerning decisions by officers of the Revenue on matters including national insurance contributions) that s 14(3) of the 1996 Act had a wider meaning than that contended for by the employee.

The appeal would be dismissed.

Section 14(3) of the 1996 Act was not directed exclusively to determinations made under the Regulations, including reg 80 thereof, but was apt to include decisions made under s 8 of the 1999 Act and, in a broader sense, directions by a public authority in accordance with statute (for example, the Revenue) to an employer to make a deduction of a relevant figure (see [17], [22], [28] and [30] of the judgment).

Both determinations in relation to 'pay as you earn' (PAYE) and decisions in relation to national insurance contributions were covered by s 14(3) of the 1996 Act. There would be no scope for exceptions of decisions made in relation to the latter if a narrow construction were taken to s 14(3). The scheme of the 1996 Act was such that disputes which arose in specific fields fell to be determined by specific designated authorities (for example, tax matters fell under the aegis of the tax regime, and statutory sick pay under the social security regime) and exceptions flowed from that general starting position, notwithstanding the fact that duplication might occur (for instance, a payment under a PAYE requirement could be exempted under both s 13(1)(a) and s 14(3) of the 1996 Act) (see [22] and [23] of the judgment).

In the instant case, the tribunal's ruling on the issue of jurisdiction was correct. In essence, the dispute between the parties related to a deduction of money in accordance with a decision made by an authority that the sum specified (namely, £65,000) should be paid over to it by the employer. Accordingly, the deduction was not, as the employee had contended, a matter which could have had been tried on the basis that s 14(3) of the 1996 Act was not applicable (see [29] of the judgment).

Accordingly, the ruling under challenge would be upheld.

Revenue and Customs Commissioners v Larkstar Data Ltd

Regulation 6 of the Social Security Contributions (Intermediaries) Regulations 2000, SI 727/2000 provides, so far as material: '6(1) These Regulations apply where – (a) an individual ("the worker") personally performs, or is under an obligation personally to perform, services for the purposes of a business carried on by another person ("the client"), (b) the performance of those services by the worker is carried out, not under a contract directly between the client and the worker, but under arrangements involving an intermediary, and (c) the circumstances are such that, had the arrangements taken the form of a contract between the worker and the client, the worker would be regarded for the purposes of Parts I to V of the Contributions and Benefits Act as employed in employed earner's employment by the client. (3) Where these Regulations apply – (a) the worker is treated, for the purposes of Parts I to V of the Contributions and Benefits Act, and in relation to the amount deriving from relevant payments and relevant benefits that is calculated in accordance with regulation 7 ("the worker's attributable earnings"), as employed in employed earner's employment by the intermediary, and (b) the intermediary, whether or not he fulfils the conditions prescribed under section 1(6)(a) of the Contributions and Benefits Act for

secondary contributors, is treated for those purposes as the secondary contributor in respect of the worker's attributable earnings. And Parts I to V of that Act have effect accordingly'.

Schedule 12 to the Finance Act 2000 provides, so far a material: '(1) This Schedule applies where: (a) an individual ("the worker") personally performs, or is under an obligation personally to perform, services for the purposes of a business carried on by another person ("the client"), (b) the services are provided not under a contract directly between the client and the worker but under arrangements involving a third party ("the intermediary"), and (c) the circumstances are such that, if the services were provided under a contract directly between the client and the worker, the worker would be regarded for income tax purposes as an employee of the client. (4) The circumstances referred to in sub-paragraph (1)(c) include the terms on which the services are provided, having regard to the terms of the contracts forming part of the arrangements under which the services are provided'.

TPS Int Ltd (TPS), was a company which acted as an agency for the engagement of contractors by a third company, MBD UK Ltd (MBD), which at the material time worked on defence missile systems and was engaged on a long project which required specialist computer services. For the purpose of acquiring these services MBD entered into agreements with TPS for their procurement. Starting on 11 August 2000, LD Ltd, the taxpayer company, which was in the business of providing computer consultancy services, entered into a series of agreements with TPS for the provision of computer consultancy services to MBD. Pursuant to those agreements the taxpayer provided to MBD the specialist services of its sole director, B, which he provided for MBD at its premises. There was no direct contract between B and MBD; he was the person whom the taxpayer provided for the purpose of fulfilling its contractual obligations to TPS. However, the Revenue and Customs Commissioners took the view that those arrangements were such as to fall within the anti-avoidance provisions contained in Sch 12 to the Finance Act 2000, dealing with income and corporation tax, and reg 6 of the Social Security Contributions (Intermediaries) Regulations 2000, SI 727/2000 (the Regulations), dealing with national insurance contributions. Those provisions together were commonly referred to as the IR35 legislation. Consequently, the Revenue served notices of determination and decision on the taxpayer on the basis that the IR35 legislation applied. The taxpayer appealed to the General Commissioners. The General Commissioners rejected the Revenue's view that the IR35 legislation did apply in the instant case. They concluded that, had B, 'a worker' for the purpose of the IR35 legislation, provided the services he did to MBD, 'the client' for the purpose of the legislation, under a direct contract with MBD, he would properly have been regarded as an independent contractor with, and not an employee of, MDB, with the result that the IR35 legislation did not apply. The Revenue appealed against that decision. It was common ground that in respect of the instant proceedings there was no relevant difference between the terms of reg 6 of the Regulations and Sch 12 to the 2000 Act.

The Revenue submitted that the General Commissioners erred in law in that they: (i) misdirected themselves in law and in particular having identified the correct question they did not answer it, and applied the wrong test in determining whether or not the arrangements would have amounted to a contract of or for service, if they had been entered into directly with the client; (ii) misdirected themselves in law in their approach to the issues of (a) control, (b) mutuality of obligation, and (c) the relevance of a number of considerations to the question they had to determine; (iii) took into account irrelevant considerations, and based their decision on a number of findings of fact which were either not supported by the evidence or inconsistent with other findings of fact; and (iv) reached a conclusion which was not open to them on the evidence before them'.

The appeal would be allowed.

The conditions of sub-paras (a) and (b) of Sch 12 to the Finance Act 2000 involved an analysis of the actual facts and legal relationships, but when that analysis showed that those two sub-paras were satisfied, sub-para (c) involved an exercise of constructing a hypothetical contract which did not in fact exist, and then inquiring what the consequences would have been if it had existed. There might be room in some cases for dispute about what the hypothetical contract would contain. Clearly superintendence and control could not be the decisive test when one was dealing with a professional man, or a man of some particular skill and experience. In such cases there could be no question of the employer telling him how to do work; therefore, the absence of

control and direction in that sense could be of little, if any, use as a test. Clearly superintendence and control could not be the decisive test when one was dealing with a professional man, or a man of some particular skill and experience. In such cases there could be no question of the employer telling him how to do work; therefore, the absence of control and direction in that sense could be of little, if any, use as a test.

Having considered the General Commissioners' conclusions on the relevant issues, it was clear that they had misdirected themselves in relation to their consideration of what they found to be the questions of control and mutuality of obligation, and had made one finding of fact in relation to the former question namely that B was only encouraged to work the core hours, which was unjustified by the evidence before them (see [58] of the judgment).

The matter would be remitted to the General Commissioners to be heard afresh by a differently constituted panel.

Littlewood and another and another v R&C Commissioners SpC 733

The first appellants, Mr and Mrs L, traded in partnership fitting windows and doors in commercial buildings. The second appellant, Mr M, was one of their workers. When Mr L was offered a contract, he discussed the details with the charge hands who were the spokesmen of the teams of workers and worked out the pricing of the job and the amounts to be paid to each team member. The charge hands also liaised with the client's contract manager and together they would resolve any problems with the job. The workers were paid on the basis of a rate for a day's work which continued while the contract was running, and they were paid on a "price" basis. No payment was made for a day or part of a day when a worker was not on site. Workers were left to choose their own hours but were aware that if the work fell behind schedule the contractors would charge a penalty. The workers did not receive any holiday pay or sick pay, and there was no grievance procedure. There was no written contract between the partnership and the workers. The workers did not submit invoices, but the charge hands did send time sheets to the partnership and Mr and Mrs L prepared time sheet records relating to all the workers; in some cases the workers could not read. There was no notice period required by either party; the workers came and left as they pleased. Mr L did not tell the workers how do to the job—he was rarely on site but he tried to visit once a fortnight to see how the job was progressing. As some of the workers needed training in order to obtain a "CSCS" card to permit them to be admitted to the sites, Mr L made the initial payment for such training and then deducted the amount from the relevant worker. In relation to one project, the N project, the contractor had gone into administration and the partnership did not recover any of the money it was owed and it was accepted by the onsite workers that they would not be paid. HMRC made formal determinations under the Income Tax (Pay As you Earn) Regulations 2003, SI 2003/2682, reg 80. HMRC also issued notices of decision under the Social Security (Transfer of Functions) Act 1999 s 8 in respect of a number of workers, including Mr M, that they were employed earners in respect of such work. Mr and Mrs L and Mr M appealed and the appeals were heard together. HMRC argued that the three basic requirements for employment—ie mutuality of obligation, control, and that the other provisions of the contract were consistent with it being a contract of service—were satisfied. They submitted, inter alia—(i) that all that was required by the term mutual obligation was that there must be a contract, whether written or oral, that was an agreement by one party to work and by the other party to pay for that work. It was not necessary that there was an ongoing obligation to provide work on the one hand and to do it on the other. A relationship between a putative employer and employee, under which the engager could offer work from time to time on a casual basis, without any obligation to offer the work and without payment for periods when work was being done, might nevertheless be employment; (ii) in relation to the personal service and substitution condition, Mr L had admitted in his statement that he had paid a worker's helper direct. Where the helper was paid direct by Mr L, that created a separate contract with the helper and that contract was a contract of service; at the very least it was a separate contract, and did not show that the earlier contract with the worker was itself a contract for services; (iii) it was the right to exercise control that was significant, regardless of whether that right was exercised. As the charge hands carried out a supervisory function and workers moved between sites those factors were sufficient to constitute control in the instant case. The appellants argued that—(i) mutuality referred to an obligation to accept and perform the work. It was important that it was

not confused with the situation where a worker merely in fact turned up and then was paid for the work undertaken. It was necessary to consider whether in fact mutuality existed in one off jobs. On the authorities the need for mutual obligations—ie the obligation on the engager to offer work and the obligation on the workers to accept and peform it—was an essential pre-requisite for a contract of service. In the present case there was no mutuality in the overall relationship between the workers and the partnership, because there was no obligation on the partnership at any stage to offer work to any of the workers and no obligation on them to accept it. There was no mutuality in relation to individual engagements—the N project had just stopped which demonstrated the lack of mutual obligations within that contract; (ii) on the personal service and substitution condition it was the power of delegation that mattered, not the frequency of its use; occasional use was not the test. Mr L gave evidence that he assumed on most jobs the workers used their own helpers, and they paid them; and (iii) in relation to the control test the question was who in reality had the power to control what the worker did and how he followed it, and it could include not just how work was undertaken but when and where. On the facts there was no actual day-to-day control of the workers.

The Special Commissioner considered that it was unnecessary in individual assignments to show that there was an obligation to provide work and obligation to perform it. Mutuality in relation to individual assignments did not require the elements mentioned in the cases relating to a series of assignments. The threshold for mutuality in individual assignments was modest, but the question of mutuality on its own could not establish the nature of the contract. For that other factors had to be examined. On the facts there was no mutuality in the long-term sense of providing continuity of the engagement. But there was mutuality of obligation in each of the individual assignments undertaken by each of the workers—the worker agreed to carry out the work, and the partnership agreed to pay the worker for that work. However, a finding that there was mutuality of obligations within each assignment was not enough to determine the nature of the contract.

The Special Commissioner considered that the power of delegation, if limited or occasional, could still exist without preventing the conclusion that the contract in question was one of employment. In the instant case, the use of helpers could only be described as occasional. That was not a significant factor in determining the nature of the contracts.

The Special Commissioner considered that both mutuality of obligation and control had to be established before it was appropriate to move on to other tests to examine the nature of the contract. In the absence of either of those elements, the contract could not be seen as one of service and so the other tests became irrelevant. In relation to the control test, the retention of a right of control could be sufficient, although control over merely incidental matters was unlikely to suffice. However, in the present case there was insufficient control exercised by the partnership. The workers operated in teams, and the charge hands spoke for those teams, both in dealing with Mr L in relation to the pricing of a particular job, and in dealing with either the door company or the site contractor. On the basis of a particular worker's experience, Mr L might choose him to be a charge hand to represent a team of workers, but that did not amount to a process of appointment. Furthermore the workers acted independently of Mr L and agreed matters within their teams, membership of which was not chosen by Mr L. The team members had to act within the instructions of the persons running the site. Mr L's site visits were to check the progress of the job, to ensure that the contract was being fulfilled and to take account of any changes needed to the pricing to allow for extra work which had not been included in the fixing of the price charged by the partnership to its client. As it was not clear that movement of workers between sites was within the control of Mr L, it could not be included as a factor in assessing whether he had control of the workers. Furthermore the preparation of time sheet records and the provision of training was a neutral factor in relation to the control test. Accordingly the contracts were not contracts of service. That was sufficient to determine to determine the appeals in the appellants' favour. Appeals allowed.

Mayes v Revenue and Customs Commissioners SpC 729

In his tax return for the tax year 2003–04 the appellant, M, a UK resident, claimed he was entitled under TA 1988 s 549 to deduct £1.8m as a corresponding deficiency against other income for higher rate income tax purposes. Section 549(1) provided that "… where such an excess as is mentioned in section 541(1)(a)—(a) would be treated as a gain arising in connection with a policy or contract, and (b) would form part of an individual's total income for the year of assessment in which the final year ends, a corresponding deficiency occurring at the end of the final year shall be allowable as a deduction from his total income for that year of assessment". The appellant also claimed relief of £131,323 against gains liable to capital gains tax. Both claims arose under a tax avoidance scheme marketed as SHIPS 2 which used the payments of premiums to and subsequent surrenders, in part and then fully, of existing non–qualifying life assurance policies (or second hand insurance policies) in order to provide higher rate income tax relief. The scheme was presented as a short series of steps relating to the simple sale of individual bonds—which consisted of groups of 20 single premium life assurance policies sold together—by A, a company in the UK. Under the scheme L, a Jersey resident, purchased two bonds on 2 April 2002 ("step one"). On 6 March 2003 L assigned the bonds to a Luxembourg company, J, for value ("step two"). The following day J paid A £375,000 for each policy in the first bond and £50,000 in respect of each policy in the second bond ("step three"). On 31 March 2003 J withdrew from the bonds the sums that had been paid in in their entirety ("step four"). On 6 November 2004 J assigned the bonds to P for value ("step five"). On 18 December 2003 P assigned the bonds to M for value ("step six"). On 13 February 2004 M surrendered both bonds to A receiving in return the remaining proceeds in the bonds ("step seven"). The scheme relied on a strict application of the timetable incorporated in the calculations required for TA 1988, Pt XIII, Ch II. In accordance with TA 1988 s 546(4) all the events were treated as occurring in one "year" on the basis that M's purchase and the withdrawal from the bonds occurred within the same tax year and so was treated as being the end of the final year. The first year started when L bought the bonds on 2 April 2002 so the second year began on 2 April 2003 which was also the final year, so that s 546(4)(b) was activated and para (a) made the period from 2 April 2002 to 13 February 2004 a single year, so that only one calculation needed to be done under s 541(1)(b). HMRC disallowed the income tax relief claim on the basis that, looking at matters in the "real world", the apparently separate initial steps that preceded the bonds being sold on to P were in reality not separate steps at all; that steps 3 and 4 should be seen together as a preordained composite transaction devoid of commercial content and therefore the involvement of J in the steps had no enduring consequences; that accordingly the income tax relief should be looked at on the basis that those steps did not form part of the background to the appellant's claim; and that if those steps were removed from the scheme, then there was no corresponding deficiency claim and no chargeable loss. The appellant appealed on the grounds that an event by event analysis had to be adopted. Once money had been paid into a policy, there was a consequence which had to be viewed separately from any surrender or part surrender of the policy, and any question of purpose had to be examined to identify whose purpose was in question; and that much of the detail of the scheme was irrelevant to him and to his claim for tax relief. It was common ground that the claim for capital gains tax loss had to be considered in the light of *Drummond v Revenue and Customs Comrs* [2008] EWHC (Ch) 1758, [2008] STC 2707.

The Special Commissioner considered that TA 1988, Pt XIII, Ch II was constructed as a sequential series of interlocking provisions, not a series of isolated tax charges and tax reliefs. Accordingly the evidence of what happened in each of the seven steps was relevant evidence. On the facts the scheme was part of a major co–ordinated purchase of bonds that required the deployment of significant third party funding. L paid a composite premium of £250,000 with his colleague, another Jersey resident, purchasing a similar value of funds. The £500,000 required to finance the purchases was provided by a Jersey bank, S. In order to protect its investment S took a charge over, and assignment of, the bonds. The interest payable on the loans under the financing agreements was determined by the income generated on the bonds, and L and his colleague made no net profit from the purchase of the bonds, and S made a small loss on the loans. S was also behind steps two to five, as was J and five other Luxembourg companies brought in to share the risks, and S provided loans totalling £300m to finance those companies investing in the life policies. That investment lasted one month and the companies used the funds withdrawn from the policies in order to repay S and then sold the policies. A was also involved in steps two to five, and A and S agreed special terms for the investments into, and the subsequent partial surrenders, of the bonds. A received funds for each of the bonds and that series of

arrangements constituted step two. But underlying the apparent sale of the bonds from L to J was a situation where the bonds were, for all but a short period, held by S and the transactions, including the establishment of J, were financed by S both before and after the transfer. Further S had effective control of the implementation of step three. S instructed A to encash all but £5,000 of each bonds, with proceeds being transferred to S. The papers showed that J continued as owners in name of the bonds, with each now having a value of just 14p more than the initial value a year before. Under step five, P received the bonds at, in effect, market value with no premium attached.

Having regard to the "real world" which in the present case involved an examination of the full context of the steps taken, the Special Commissioner found that the steps had several aspects in common. Firstly, the seven steps were not individual disconnected events. Step one was not in reality a purchase of two £5,000 bonds—it was a major purchase of bonds worth £500,000. Step three was not in reality a payment to A by J of a sum of money merely in respect of the two bonds later sold to M; it was a closely co–ordinated major funding exercise under which £300m was deposited with A. Secondly, the funding was provided or organised by S. Thirdly, the commercial reality of the steps, or rather, its absence. Fourthly, some of the players in the scheme were involved not in isolated steps but on a continuing basis. Fifthly, the choice of jurisdictions was another continuing element in the planning evidencing a multi–layered scheme. Putting it at its simplest, the money did not only move through the steps, it also moved through at least three tax jurisdictions at the same time. Lastly, the continuing absence of evidence of any interest in L's health or, indeed, whether he was actually alive once step two was completed showed that little attention was paid to the life assurance aspects of the bonds. They did not appear to have been a prime mover in the choice of investment save in so far as the life assurance element attracted the tax treatment available from Ch II. Each of those common elements was to be borne in mind when considering the proper approach to applying the individual sections of TA 1988, Pt XIII, Ch II to the events under appeal.

The Special Commissioner considered that the question was whether a corresponding deficiency could be claimed by the appellant under TA 1988 s 549 by reference to a previous chargeable event consistently with s 539 and the other sections in the Chapter when the deficiency related back not to an actual chargeable event but to the co–ordinated series of actions evidenced here. That series of actions did not actually give rise to a chargeable event in the sense that anyone was charged to income tax, or identified as chargeable to income tax, on it. But it was said to generate a deficiency out of all proportion to the actual amounts of premium paid into and out of the bond by L and the appellant because, and only because, of the pre–arranged and self–cancelling payments and refunds by and to third parties. On the facts, there was no corresponding deficiency for income tax purposes. The payment of sums of money to A pro rata into the bonds was formally in the name of J. The subsequent pre–arranged withdrawal of all those funds pro rata from those bonds after a brief period was in the name of J. But in reality the investment of funds was arranged by, the encashment of funds was ordered by, and the funds came from and went directly to, S. Steps 3 and 4 were pre–arranged self–cancelling steps with no commercial purpose to J or its immediate funders other than the tax advantage that it was intended to secure in the UK under the terms of Ch II on the onward sales of the bonds through a third party associated with the funding operation. They followed a pre–set timetable that had been discussed by all concerned. The encashment had been arranged with A before the funds went in, and was understood by A to be part of the deal under which it received the deposit. As such, to apply TA 1988 ss 549 and 539 to steps 3 and 4, with the result that the two steps generated a "reckonable aggregate value" such as to create a "corresponding deficiency", would not be a rational application of Ch II and was not intended by the legislature. It followed that the appeal would be dismissed in so far as it related to the contended amount of corresponding deficiency relief. If there was any relief it was to be calculated without reference to any of the sums paid into the bonds, and then withdrawn again, by J.

Turning to the capital gains position, the Special Commissioner considered that the question was whether the sums paid by M to P for the bonds were, for capital gains tax purposes, "consideration given by him … wholly and exclusively for the acquisition of" the bonds within the meaning of TCGA 1992 s 38(1)(a). On the facts M did have a capital loss in buying the bonds and an amount was allowable to the appellant for the loss of the final surrender of the bonds; *Drummond v Revenue and Customs Comrs* [2008] STC 2707 applied. Appeal allowed in part in principle.

Simpson and others (Trustees of the East Berkshire Sports Foundation) v R&C Commissioners SpC 732

The three appellants were the directors of their local football club and donated over £123,000 to improve the club's pitch and premises which had fallen into disrepair and its first team had been relegated to the bottom league. In August 2003 the appellants decided to create a sports foundation (E) as a charitable trust to enable them to donate funds to it equal in value to their loan balances with the club whereupon E would distribute the same amounts to the club which in turn would repay the directors' loans. E would then apply to recover tax repaid by way of relief under FA 1990 s 25 ("gift aid") which it would donate to the club to pay for further improvements. The chairman of the club, S, who was a solicitor, drafted the trust deed and the objects of the trust adopted the wording of the Recreational Charities Act 1958, and E was registered in the Central Register of Charities. Clause 12 of the trust deed exonerated the trustees from liabilities, save where they had been found guilty of some fraud or dishonesty. The directors wrote three letters of request to the club requesting repayment of the directors' loans, totalling £60,000, to E. On 14 November 2003 a meeting of both the club and E took place. The club minutes noted the repayment and requested that they be paid to E but no steps were taken to effect repayment. The minutes of the trustees of E stated that upon receipt of those funds, E would apply the monies for "charitable purposes". The following day E wrote to the club enclosing a cheque for £50,000. On 18 November 2003 E and the club swapped cheques for £50,000. The appellants made gift aid declarations in respect of the donations to E for the £60,000 identified in the letters of requests and the basic rate of income tax was refunded to E. In February 2004 directors called for repayment of a further £60,000 which followed the same procedure as before and gift aid declarations were again made and reclaimed by E. However on that occasion E did not write to the club and no cheques were swapped. Although HMRC initially allowed the gift aid claims they subsequently made assessments to recover the repaid income tax on the grounds the donations to E had not ranked as qualifying donations to charity within the meaning of FA 1990 s 25. The assessments were issued in the name of E but after E was wound up by the trustees in 2007, HMRC issued new assessments in the name of each of the trustees. The appellants appealed.

The Special Commissioner considered although only the £50,000 amounted to a payment of a sum of money within the meaning of FA 1990 s 25, the recipient was not a charity and accordingly the assessments made to recover income tax on the appellants were good. On the facts, although it was finely balanced, the £50,000 donation amounted to a payment of a sum of money within the meaning of FA 1990 s 25—in November 2003 the directors called for immediate repayment of £60,000 to be made, and to be made to E, £50,000 was then paid immediately by cheque, and it was irrelevant that the payment was not actually made by the directors themselves, but was procured by them. However, on the assumption that cheques were not exchanged in respect of the February 2004 transactions, those debts were presumably extinguished or satisfied by set-off, in that when E was wound up, it was said to have no remaining assets and liabilities. Accordingly the effect of the directors' letters of request was to assign loans owed by the club to E that were acknowledged in its September 2004 accounts, and implicitly thereafter satisfied by set-off.

The Special Commissioner considered that it would be legitimate for a charity designed to promote recreation to distribute money to a club, whose objects could not be charitable, so long as, in ensuring that the charitable requirements were met, the trustees gave particular attention to whether the items for which they were making contributions fostered public benefit in the requisite manner. On the facts, the club was not, and could not have been, a charity. RR11 (2003 edition) applied in the present case which made it clear that, in the relevant context of football, for a club to be charitable, it had to be open and available to all, regardless of ability, and the raison d'être of the club had to be that of providing a sporting facility for all. It was then acknowledged that sport was competitive so that clubs would often want to compete and to form teams, but the clear emphasis was that the team element had merely to be an incident of the provision of sport for all generally. The teams were there to foster the ambition of the members generally to improve and to join the teams. In terms of RR11, the club's emphasis and whole rationale was the wrong way round—the club was principally a club for the first team and the other teams, and its principal object was to compete in outside leagues, and opportunities offered to the public were secondary. They needed to be the prime driver, and team activities needed to

be an adjunct of the public benefit. Accordingly although the club was not charitable that would not have been fatal had the trustees, at the meeting in November 2003, specifically addressed the aspects of the club's activity which were targeted at the public generally. Accordingly, the proposition that consideration was given to which costs a charity could properly meet was not made out, and as it was obvious that much of the improvement work was designed to lift the fortunes of the club as a football club, and particularly to halt and reverse the decline in the performance of the first team that had seen it drop several leagues, that was not the right approach for a charity to take.

However the Special Commissioner found that in any event E was not a charity. Whatever the objects of the charity were stated to be in its trust deed, the real and clear object was to filter the totality of donations that it received to the club in order to meet all the costs that had been met out of the directors' loans, and thus enable those loans to be repaid. Furthermore, the appellant trustees could be assessed to tax now E had been wound up. As no clause in a trust a trust deed could possibly eliminate liability to taxation plainly imposed on the trustees, cl 12 of the trust deed did not exempt them from liability. It followed that the appeals would be dismissed. Appeals dismissed.

Non UK domiciliaries – steps to be taken before 6 April 2009

While it would be wrong to say that all the ramifications of the FA 2008 changes to the tax treatment of non-UK domiciliaries are now clear, there is a growing appreciation of what such individuals should be doing with their personal assets and what action the trustees of trusts created for the benefit of non-UK domiciliaries should be taking in relation to the property under their control.

This update provides an overview of points which individuals and their trustees need to consider in the run-up to 6 April 2009.

The current situation has been summed up by one firm of tax advisers as follows:

> 'We have now lived with the new regime for the best part of its first tax year and it is clear that, whilst the new regime creates significant complexity for advisers and those who implement that advice, for clients the (overall position) can be summarised relatively straightforwardly. If income or gains are used in any manner or form in the UK by or for the benefit of a remittance basis taxpayer, their spouse or minor children and grandchildren, or are brought to the UK by any structure for their benefit, then a liability to tax will arise. If the funds are retained outside of the UK, then no liability to tax arises. Using those simple terms, the regime is probably neither unfair nor excessively complex and conceptually it is quite easy to explain.
>
> This is important from the perspective of UK plc. Many commentators have pointed out the manifest failings of the new regime and it is true that it is far from perfect. In some senses, it is a dangerous regime, particularly for those who did not take advantage of the pre-6 April 2008 window to undertake planning. It is, however, important that the UK is not seen to be a jurisdiction whose tax regime makes it an unattractive place for a wealthy non-UK domiciliary to be based. In our view, the UK remains an attractive jurisdiction for the well-advised, but it is now a jurisdiction where great care is required in structuring an individual's arrangements, since the traps for the unwary have become far more menacing.'

For individuals, the main action points to be considered are:

1. Decide whether or not to be a remittance basis user. Many non-UK domiciled clients should undoubtedly become remittance basis users, but there will be a number of individuals whose unremitted foreign income and gains are such that claiming the remittance basis and, if they are long-term residents, paying the £30,000 additional tax charge will simply not make sense. The decision whether to pay the £30,000 does not of course have to be made until 31 January 2010, but there are steps in this regard which can be taken now and which may well be advisable (eg. remitting income or gains to the UK in 2008/09 and leaving less than £2,000 of unremitted income and gains abroad). If an

individual has unremitted income and gains of less than £2,000 for a tax year, he will qualify for the remittance basis automatically without having to hand over the extra £30,000.

2. Decide whether to pay the £30,000 for 2008/09. It should be remembered that payment of the £30,000 additional tax charge in any one tax year does not presuppose that it has to be paid in each succeeding year. The decision is made on a year-by-year basis. If the £30,000 is to be paid, the account from which it will come should be identified.

3. Decide, if relevant, whether only one family member should pay the £30,000. Steps can be taken to ensure that the £30,000 charge is only payable by one member of the family. This involves arranging for the overseas assets to be held by that individual (and not spread around among other family members). Care is needed when implementing tax planning along these lines.

4. Consider whether the foreign income or gains can be restructured so that there is no tax liability on money not remitted, even if the £30,000 charge is not paid. Many families have examined the possibility of using investment products such as deferred interest bank accounts and offshore life bonds to mitigate the impact of the FA 2008 regime. There is still time to put in place products such as these for the present tax year or, more realistically, for 2009/10.

5. Avoid remitting funds from the account nominated to meet the £30,000 charge. If funds are remitted from a non-UK domiciliary's nominated account, the individual is *not* treated as remitting the relevant income or gains. Instead, the legislation sets out what income and gains *are* treated as being remitted, and in a way which is invariably to the taxpayer's disadvantage. The best advice to clients is not to remit funds from the account which has been nominated. Many taxpayers who decide to pay the £30,000 are therefore setting up what are known as 'nominated income and gains' accounts – often with relatively small balances – which they then identify as their nominated accounts and from which money will never be remitted. Such accounts should be put in place prior to 6 April 2009. It does not matter if the funds in them are less than £30,000 – this is a key planning point.

6. Consider what should be done with foreign capital losses. Following FA 2008, remittance basis users have the facility to make an election under which their foreign capital losses become allowable (see S16ZA TCGA 1992). The pre-6 April 2008 position was that losses on foreign assets could never be set against overseas gains taxable on the remittance basis – they remained unrelieved. Such losses are now dealt with in the following order:

   (i) against overseas gains remitted in the year in which they arise; then

   (ii) against unremitted overseas gains; and finally

   (iii) against UK gains.

However, if an election is made, this order of set-off also applies to losses on UK assets (which hitherto could only be set against UK gains). Whether it is sensible to make such an election is a question which is almost impossible to answer since it must be made in respect of the first year for which the remittance basis is claimed under the new regime and, once made, is irrevocable. As one commentator has remarked:

'Who knows where losses will arise in future years and whether they can be used or whether foreign gains will be remitted?'

Clearly, in some situations, the ability to set foreign losses off against gains will result in a tax saving. For others, making the election could result in UK losses being wasted if they are set against foreign gains which are not remitted. Having said that, a decision must be made and the taxpayer should make the best guess possible.

Decide how to make optimum use of any pre-6 April 2008 foreign income and gains (which, broadly, continue to benefit from the old – and narrower – remittance basis rules).

Trustees

The action points for trustees are quite different. Given the reduction in the CGT rate to 18% and the fact that capital payments from an offshore trust to UK-resident but non-UK domiciled beneficiaries will in future be taxed on the remittance basis, thought should be given to the possibility of

converting trust assets to investments producing capital gains rather than income or offshore income gains (both of which will be taxed at the maximum rate of income tax, expected to be 45% for 2011/12 onwards).

Trustees also need to consider whether to file a rebasing election, using the new form RBE1. This rebasing election effectively revalues the trust assets to their worth on 6 April 2008. In many cases, the value of assets at 6 April 2008 will be higher than the value of those assets in 2009 and, in this context, a rebasing election seems like a sensible idea. The election has to be filed by 31 January 2010 if, in 2008/09, either the trustees have made capital payments to UK-resident but non-UK domiciled beneficiaries or there has been a transfer between trusts. This election must be made on the first possible occasion and, if overlooked, the opportunity is lost forever. As a consequence, trustees might like to consider making a small capital payment before 6 April 2009 in order to trigger the requirement to make the election so that it is not inadvertently missed at a later date. Having said all this, many trustees have concerns about filing a rebasing election with HMRC and thereby disclosing the existence of the trust. Nonetheless, whatever the validity of these concerns, the interests of the beneficiaries have to be served at all times and it may well be in their best interests for form RBE1 to be completed and submitted to HMRC. These rebasing elections will clearly be an important source of information – and possibly investigation – for HMRC in future years.

In view of the fall in value of most classes of assets since 6 April 2008 (and, in particular, UK real estate), the current time may represent a good opportunity for trustees to appoint capital assets to UK-resident but non-UK domiciled beneficiaries without crystallising a CGT charge.

Article by Robert Jamieson

Lecture P525 (24.29 Minutes)

Capital Gains Tax

Entrepreneurs' relief problem areas - Property retained outside the company

Where a property has been retained outside a company on incorporation – a very common situation, then the owner will be seeking to take relief on an associated disposal. The following key issues should be considered in advising the client :

- The client now has the choice to switch the property into the company or alternatively to retain it outside and plan to take Entrepreneurs' Relief on the eventual disposal by way of the material disposal provisions.

- Switching the property into the company will attract SDLT on the value of the property. However, it will enable the property to count as part of the material disposal gain when the shares in the company are disposed of.

- Putting the property into the company will also provide protection for Inheritance Tax, promoting the rate of relief from 50% maximum to 100% at current rates.

- If the property is retained outside the company, a subsequent disposal of the property **must** take place at the time the owner sells his remaining shares in the company (at a time when he still holds at least 5% of the ordinary share capital). It does not, however, have to be sold to the purchaser of the shares, and could be sold to an unconnected third party. Any sale at any other time will be fully taxable at 18%.

- Retaining the property outside the company allows flexibility should the property become surplus to requirements and the owner seek to let it to a third party. Inside the company there is a risk that this would deny Entrepreneurs' Relief on the value of the shares as letting the property would be a non trading activity. This would compromise the trading company status and therefore deny relief on the shares.

- Where a rent has been charged for use of the property by the company, which will commonly be the case where the property was purchased by the owner raising a mortgage on it, the rent charged in the past (which would not have been an issue for Taper Relief) will deny Entrepreneurs' Relief on a post April 2008 disposal. Only rent charge after 6 April 2008 is taken into account for the purpose of restricting the relief.

Article by Rebecca Benneyworth

HMRC views on property related goodwill

In the past HM Revenue & Customs (HMRC) have taken the view that it was unlikely that there would be 'free goodwill' of any significant value in businesses carried out from trade related properties (for example public houses, hotels, petrol filling stations, cinemas, restaurants, care homes etc) because the occupation and use of the particular, specially adapted, premises was usually essential and integral to the generation of the business income.

However, it is now acknowledged that when a business is sold as a going concern the sale price will reflect the combined value of the tangible assets together with the benefit of other business assets such as any contracts with customers, staff and suppliers, records of previous customers etc. Substantial value can be realised by combining the tangible and other business assets together for sale as a going concern but this enhanced value may be reduced if the assets are split and sold separately.

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In the unusual event of this type of business being transferred without some form of property interest, it would be highly likely that the value otherwise achieved, would be substantially diminished or removed. This is why such businesses are rarely, if ever, transferred without any form of property rights.

It remains important to recognise this distinction from most other businesses where there is no such reliance on a specific property interest and business goodwill can be readily sold and will be of value irrespective of the actual premises. Recently published articles in the professional press do not fully address this important distinction and appear to misinterpret some fundamental valuation issues.

There are a host of real and practical reasons why the assets in such premises cannot be actually separated without depreciating their combined value but HMRC now accept that for taxation purposes HMRC need to recognise the contribution that each asset makes to the combined value.

The HMRC Practice Note released on 30 January 2009 explains the issues in more detail and sets out how HMRC and the Valuation Office Agency (VOA) consider one should go about apportioning the price paid for a business as a going concern between goodwill and other assets included in the sale. The Practice Note reflects the VOA view that the appropriate method of valuing this type of property is by reference to the profit making potential of the premises. The VOA are currently discussing this valuation approach with the Royal Institution of Chartered Surveyors.

The Practice Note is extremely important and elements of the Practice Note are reproduced below. It should however be noted that this Practice Note has not been well received and further professional comment is expected.

Practice Note: Apportioning the Price Paid for a Business Transferred as a Going Concern

1. Background

1.1 An apportionment of the price paid for a business as a going concern between the underlying assets may be required for tax purposes in a number of instances, for example:

a. For the purpose of calculating the capital gains arising on the disposal of the separate assets in accordance with the TCGA 1992.

b. On an acquisition for the purpose of calculating the SDLT due on the interest in the land and buildings only.

c. On an acquisition for the purpose of calculating the allowances available against Corporation Tax for Capital Allowances, such as Machinery and Plant Allowances (see Section 3), or for purchased goodwill (Schedule 29, FA 2002).

1.2 Price paid for a business sold as a going concern may include any or all of the following assets:

a. The land and buildings including landlord's fixtures ('the property').

b. The trade fixtures, fittings, furniture, furnishings and equipment ('the chattels').

c. Any transferable licences.

d. Goodwill

e. Other separately identifiable intangible assets (eg. registered trade marks).

The purchaser may also separately acquire consumables and stock but these are usually valued separately and will not normally be included in the sale price to be apportioned.

1.3 Some of the principles set out in this Practice Note are applicable to apportionments for all types of businesses but the note deals mainly with the particular issues that have arisen where the property is a 'trade related property' valued using a profits approach (eg. public houses, hotels, petrol filling stations, cinemas, restaurants, care homes etc). In these cases there can be particular difficulties in identifying the sum attributable to 'goodwill' and this is fundamental to the apportionment.

2. The Statutory Provisions

2.1 For the purposes of calculating a capital gain s.52 of the TCGA 1992 provides that any apportionment shall be on a 'just and reasonable' basis.

2.2 For the purposes of calculating any SDLT due paragraph 4, Schedule 4, FA 2003 similarly provides that any apportionment shall be on a 'just and reasonable' basis.

2.3 For the purposes of calculating any Capital Allowances claimed s.562 CAA 2001 similarly provides that any apportionment should be on a just and reasonable basis.

2.4 For the purpose of calculating the cost of purchased goodwill paragraph.4, Schedule 29 FA 2002 provides that 'goodwill' has the meaning it has for accounting purposes. Accounting guidance (FRS10) provides that 'goodwill' should be taken to be the "difference between the cost of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities" (see paragraph 11 below).

2.5 The various statutory provisions do not define the method of arriving at a 'just and reasonable' apportionment but any apportionment should generally seek to apportion the price paid between the underlying assets included in the sale on the basis of their relative values and the contribution they make to the price that is being apportioned.

3. Legal Definitions of Goodwill

Not reproduced for the purposes of this course.

4. Accountancy and International Valutaion Standards Council Definitions

Not reproduced for the purposes of this course.

5. Goodwill in Trade Related Properties

5.1 It has in the past been argued that because the business in trade related properties is usually largely or wholly incapable of being sold separately from the property there is little or no goodwill (see the Lands Tribunal decision in Coles Executors v IRC (1973) concerning the valuation of a public house for Estate Duty). On the sale of a business operated from such properties, unless there were other separately identifiable intangible assets included in the sale, the whole of the purchase price would normally be apportioned to the property and chattels, it being argued that there was no goodwill.

5.2 The above view was often put forward by taxpayers seeking to claim Capital Allowances on fixtures which formed part of the property. However, since the introduction of SDLT and the provisions in Schedule 29 FA 2002 this view has been challenged by taxpayers seeking to maximise the amount apportioned to goodwill in order to maximise their claim under Schedule 29 FA 2002 and minimise the amount of SDLT payable.

5.3 The view now is that if a business is sold as a going concern then the sale must include some element of goodwill. The question to be answered is not whether goodwill exists but what is the value of that goodwill? That question has to be decided on the facts of each individual case. In some cases the value of the goodwill may be nominal but in some it may be substantial.

6. Valuing Goodwill and Other Intangible Assets

6.1 There is a broad consensus across the valuation, accountancy and legal professions that the value of goodwill and any other separately identifiable intangible assets (eg. registered trade marks) is represented by the difference between the value of a business as a going concern and the value of the tangible assets included in the sale.

6.2 The value of a business as a going concern will usually be represented by the actual sale price achieved in the open market. However, if it is necessary to value a business as a going concern, because the sale price was not at arm's length, then this is the responsibility of HMRC (SAV).

6.3 Similarly, if it is necessary to apportion the excess value between the goodwill and any other intangible assets this is the responsibility of HMRC (SAV).

6.4 However, the difficulties in arriving at the value of the goodwill usually relate to the assumptions and approach to be adopted when arriving at a valuation of the tangible assets. This is addressed in the paragraphs below.

7. Valuing the Tangible Assets - Assumptions

7.1 Difficulties relating to the assumptions to be adopted when valuing the tangible assets often arise in cases involving trade related properties. Some of the reasons for this relate to the fact that:

a. The established approach to valuation of this type of property typically relies on the profits method and in determining the income and trading potential there can be confusion with valuation of the operator's business. The profits approach remains an appropriate property valuation basis where it is based on expected fair maintainable levels of income that are expected to be achieved from use of the property and other tangible assets by a reasonably competent operator. This is distinct from any valuation of the actual operators own business.

b. The value of such properties is often significantly reduced if the property ceases to be occupied for any length of time because customers go elsewhere and the level of trade has to be built up again by the purchaser. (The enhanced value that arises as a result of the property being occupied by the vendor and any predecessors for the particular use is part of what in the past has been described as 'adherent' goodwill but is properly part of the property value).

c. The value is often significantly reduced if the property is stripped of chattels because the purchaser has to re-fit the premises and cannot re-open until the property has been fully fitted out and is ready to trade.

d. If licences are lost there may sometimes be difficulties in obtaining new licences.

If it were to be assumed for the purposes of valuation that the property has lost any licences, been stripped of chattels and left vacant for a period of time then the value will be significantly reduced and the value of goodwill in the final apportionment, arrived at by deduction, would be inflated.

7.2 When valuing goodwill using the approach outlined in paragraph 6 above it will usually be appropriate to value all the tangible assets together for sale as an operational entity so that a purchaser can if they wish trade from the day of purchase. It is critical that this availability is reflected to ensure a fair apportionment of the sale price (and any premium arising from a sale of combined assets) between the tangible and intangible elements and avoid any over or understatement.

7.3 Another area of difficulty regarding the assumptions to be made relates to the benefit of contracts entered into by the vendor with customers, staff and suppliers. In reality, if the business is sold as a going concern, any benefit attached to these contracts will normally pass to the purchaser and will be reflected in the price paid for the business as a going concern. However, these contracts do not form part of the tangible assets so, if they add any value, the added value should not be reflected in the valuation of the tangible assets.

7.4 When valuing goodwill using the approach outlined in paragraph 6 above it is considered appropriate to assume that the benefit of any contracts with customers, staff and suppliers would either have to be acquired separately from the vendor or the purchaser would have to make their own arrangements.

7.5 Applying the assumptions in paragraph 7.4 will have different effects depending on the facts of the particular case in question. For example:

a. A small public house to be run by the purchaser with help from part- time bar staff. The purchaser has acquired the business as a going concern but there are no contracts with customers and the purchaser wishes to enter their own contracts with suppliers and employ their own staff. In such a case there may be no identifiable difference between the price paid for the business as a going concern and the price that a purchaser would pay to acquire all the tangible assets. In such a case the value of the goodwill may be nominal.

b. A nursing home, offering an element of specialist care, that is fully occupied by residents and to be run by the purchaser with the help of full-time medically qualified staff. In such a case (depending on the degree of difficulty the purchaser may face in finding any new residents and staff) there may be a significant difference between the price paid for the business as a going

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concern and the price a purchaser would pay to acquire all the tangible assets. In such a case the value of the goodwill may be more substantial.

7.6 When purchasing such a business as a going concern the purchaser will often have obtained a valuation of the tangible assets as an 'operational entity' in accordance with the RICS Red Book GN1. An alternative valuation of the property based on special assumptions (eg. vacant following a failure of the business, no accounts providing evidence of trade, stripped of chattels and licences lost) may also be obtained for bank lending purposes. For the purposes of valuing goodwill it would not be appropriate to deduct a valuation based on such special assumptions that do not reflect the actual circumstances prevailing at the valuation date. The question of the assumptions underlying a valuation of the 'operational entity' and how they may differ from a valuation in accordance with paragraphs 7.2 and 7.4 above is considered in paragraph 10 below.

8. Valuing the Tangible Assets – Valuation Approach

8.1 Having decided on the appropriate assumptions (paragraphs 7.2 and 7.4 above) it is then necessary to consider the most appropriate method of valuation. For trade related properties that are valued on a profits basis two alternatives need to be considered, these are a capitalised EBITDA/fair maintainable trade (FMT) approach and a rental value/investment based approach. The aim should be to arrive at a capital value that fairly represents the price that an owner-occupier purchaser would be prepared to pay to acquire all the tangible assets, having regard to the circumstances existing at the valuation date.

8.2 The advantages of a capitalised EBITDA/FMT approach are as follows:

a. This is the method that is used in the market to arrive at both going concern values and valuations of the tangible assets as an operational entity under the RICS Red Book GN1.

b. The valuation represents the value to an owner-occupier purchaser.

c. The purchase price paid for the going concern and any GN1 valuation of the tangible assets as an operational entity can be analysed to provide evidence of the FMT and a multiplier for the actual subject property at the valuation date.

d. It produces a value for all the tangible assets to be valued together as a single operational entity.

The difficulty with this approach is that in cases where the contracts with customers, staff and suppliers are of some value it is necessary to reflect this in the valuation. However, it is considered that in most cases this approach will nevertheless give a reliable valuation in most cases.

Example

A simple example may be a nursing home like the one described in paragraph 7.5(b) above:

Say the business had been sold as a going concern for £2m and an analysis of this sale price was say FMT £250k pa x 8YP.

If it was estimated that it would take a purchaser of the tangible assets 1 year to get the property staffed, fully occupied and trading at FMT level again a valuation using this approach may be:

£250k x 8YP	=	£2,000,000
Defer for 1 year @ 10%	=	0.909
		£1,818,000

The value of the goodwill (and any other intangible assets) would be £2m - £1.818m = £182k.

8.3 A rental value/investment based approach may be useful in some cases but as a primary method of valuation the difficulties and flaws of this approach are as follows:

a. In order to arrive at a capital value the method involves making difficult judgements not only about the FMT but the percentage of profits to adopt as the rental value and the appropriate investment yield, both of which can only be derived from comparison with lettings and sales of other properties at different dates, which significantly increase the scope for disputes over the analysis and comparability of the evidence.

b. Much of the available comparable rental evidence will relate to new lettings of properties that are either new or have previously been vacant or rent reviews/renewals that disregard the occupation of the property by the tenant and predecessors in title in accordance with s.34 LTA 1954.

c. Much of the comparable rental evidence will relate to lettings where the tenant has had to provide the chattels and the return on this capital and risk is reflected in the rents paid.

d. The valuation using this approach represents the value of the property to an investor not an owner-occupier.

e. The valuation produces a valuation of the property only to which it is then necessary to add a valuation of the chattels. It will not include the premium value to an occupier of acquiring the tangible assets together as a package with the enhanced trading potential due to the established trading history and the ability to continue trading from day1. Isolating the bare property asset may unfairly apportion any premium or share of marriage value away and overstate the intangible elements.

However, in cases where there are particular difficulties in arriving at a valuation using the capitalised EBITDA/FMT approach the rental value/investment approach may provide a guide as to the minimum value of the property to an incoming purchaser.

Example

A simple example of the problems with the rental approach may be illustrated by considering a small public house like the one described in paragraph 7.5(a) above: Say the property was trading at FMT level, it had been sold as a going concern for £1m and an analysis of this sale price was say FMT £125k pa x 8YP.

For illustration purposes, the rental value on a new letting without chattels may be say £62,500 and an investment yield may be say 8%. This would give a capital value of £781,250 leaving a balance of £281,750. If the in situ value of the chattels was say £50,000 this would leave a sum of £231,750 being attributed to the goodwill when in reality most valuers would agree that the purchaser had acquired nothing of any value beyond the value of the tangible assets. The excess is artificially created because the valuation of the property reflects its notional investment value whereas, just as with some other classes of property, the owner-occupier market is influenced by different factors and the price an owner-occupier may pay is not always the same as an investor.

9. RICS Red Book GN1 - Valuations of the 'Operational Entity'

Not reproduced for the purposes of this course.

10. Apportionment Approach – CGT and SDLT cases

Not reproduced for the purposes of this course.

11. Apportionment Approach – Schedule 29 FA 2002 cases

11.1 As noted above, for the purpose of calculating the cost of purchased goodwill paragraph 4, Schedule 29 FA 2002 provides that 'goodwill' has the meaning it has for accounting purposes. Accounting guidance (FRS10) provides that 'goodwill' should be taken to be the "difference between the cost of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities"

11.2 FRS 15 sets out the principles for calculating the 'fair value' of tangible fixed assets and provides that non-specialised properties should be valued on the basis of existing use value (EUV) (FRS15, para.53).

FRS15, para. 56 states:

> *"Certain types of non-specialised properties are bought and sold "and therefore valued" as businesses. The EUV of a property valued as an operational entity is determined by having regard to trading potential, but excludes personal goodwill that has been created in the business by the present owner or management and is not expected to remain with the business in the event of the property being sold"*

FRS 15, para. 85 states:

> *"It would not be appropriate, however, to treat the trading potential associated with a property that is valued as an operational entity, such as a public house or hotel, as a separate component where the value and life of its trading potential is inherently inseparable from that of the property".*

The above guidance on the value to be deducted appears to accord with a valuation of the operational entity in accordance with GN1. Accordingly it would not be acceptable in a Schedule 29 case for a taxpayer to put forward a value different from their valuation in accordance with GN1.

Lecture P524 (16.45 Minutes)

Inheritance Tax and Trusts

Using business property relief to alleviate IHT

Business property relief (BPR) is given by way of a reduction (usually 100%) in the value of the chargeable transfer attributable to the relevant business property provided that the property has been held for two years.

It is available to a wide class of shares or securities or property which fits the description 'a business' or an 'interest in a business' and includes unquoted shares as well as shares quoted on AIM.

Quoted shares or securities which either by themselves or with other shares or securities owned by the transferor give the transferor control qualify for relief but at the reduced rate of 50%.

Relief at 50% also applies to land, plant or machinery which is used wholly or mainly for the purposes of a business carried on by a company controlled by the transferor or by a partnership of which he was the partner.

Common sense suggests that the better course is to incorporate these assets as part of the assets of the business which would thus qualify them for 100% relief.

But it is not unknown for a partner or controlling director of a company to wish to own the land on which a company or partnership carries on business to provide him with security in old age or, alternatively, to secure that that land would not be appropriated in satisfaction of the company's debts. In such circumstances, the 50% relief may well be acceptable.

Relevant business property

The limiting factor which has given rise to the largest area of dispute with HMRC is in IHTA 1984, s 105(3) which excludes businesses dealing in securities, stocks or shares, land or buildings or making or holding investments.

Development companies

Such businesses are not in themselves excluded businesses.

However, given the current property market, many developers have resorted to letting properties pending a recovery in the property market. That change in the pattern of activity does mean that those builders have commenced carrying on a business which consists 'mainly' of holding investments.

Compare the decision in *Exors of Piercy v CIR* (SpC 687) and *Exors of Brown v CIR* [1996] SSCD 277 where the sole asset of a company – the shares in which were claimed to qualify for relief – consisted of the proceeds of sale of the nightclub formerly owned by the company.

The company had no intention of ceasing trading and was actively engaged in searching for a new nightclub from where to carry on business.

Notwithstanding the fact that nearly two years had elapsed from the date of the sale of the original nightclub it was held that the business of the company consisted of something other than the holding of investments.

Business viewed as a whole

Where relief is claimed, the business of the individual or company has to be viewed as a whole.

If there is a single business and the taxpayer can establish that, notwithstanding there is some investment activity, the business consists mainly of something other than the 'making or holding of investments' (or any other of the disqualifying activities) then relief is claimed for the value of the whole business and not merely for that part which falls without s 105(3).

Correspondingly, if the business does consist 'mainly' of making or holding investments, the value attributable to any trading activity together with the assets relating to it will fail to qualify under these provisions.

There will inevitably be cases where it will not be possible for an individual or partnership holding investment properties to claim there is one business rather than two: one consisting of an active trade not falling within the description s 105(3) and the other consisting of the making or holding of investments.

Farmer v CIR

In *Farmer v CIR* the Commissioner evaluated the various factors (turnover from different types of activity, the profit from different types of activity, the time expended, and like matters) and then stated, that after all these factors have been weighed in the balance, the court should stand back and look at the position 'in the round'.

On that basis, she found that the business was essentially or mainly the business of farming and – notwithstanding the fact that the greater value of the assets of the business consisted of a managed and let estate – the business taken as a whole was something other than one which consisted mainly holding investments.

If it is determined that the major part of the consideration provided is effectively rent given for the right to occupy a particular parcel of land it is likely that the business will be regarded as an investment business and thus disqualified for relief purposes.

If, on the other hand, the consideration paid to, say, a landlord by his tenant consists mainly of a service charge for providing a wide range of services (as in *Salisbury House Estates Limited v Fry* 15 TC 266) and only a modest ground rent is reserved, the business will consist otherwise than of holding investments. But in the latter case the value of the business is likely to be small unless the lease or other rights granted to the tenants are short term.

Holiday homes

Provided that the letting is short (that is weekly or fortnightly), and the owner or his agent is 'substantially involved' with the persons taking the holiday let and carrying on the activities there from, the business involving holiday letting will be treated as something other than the making or holding of investments.

It is not clear what 'substantially involved' means, but it is suggested that what is essential in these cases is for the owner or his agent to provide a full range of services during the holiday let including in particular the provision of daily cleaning services, bed making, periodic changes of bed linen and towels and the like.

An extension of these services to include the arrangement with tour operators and advice on excursions and local facilities will assist in going a long way to supporting the view that what is being carried on is something other than the making or holding of an investment.

Excepted assets

This is the other main area of dispute.

Where excepted assets exist the BPR will be proportionally restricted.

Section s 112(2) states 'An asset is an excepted asset relating to any relevant business property if it was neither:

> (a) used wholly or mainly for the purposes of the business concerned throughout the whole of the last two years of the relevant period defined in sub-section (5) below; nor
>
> (b) required at the time of the transfer for future use for those purposes.'

Cash deposits

Disputes here have – almost without exception – centred on cash deposits or other sums held on current or deposit account ostensibly as part of the business assets.

HMRC will have little difficulty in establishing that such cash is an 'excepted asset' if sums of cash equivalent thereto are being used for the ordinary living expenses of the transferor or for making gifts.

Likewise, if it is the practice of a company to declare dividends equivalent to the cash deposits it could hardly be said that the cash is required at the time of the transfer for future use for the purposes of the business.

Periods of ownership

IHTA 1984, s 106 lays down a minimum period of ownership.

Property must be owned throughout the two years immediately preceding the transfer.

This is extended for:

- replacement assets.
- Interspouse transfers

This is a useful provision which should be kept in mind in all cases where the two-year period of ownership has not run at the date of the death and where it is possible (whether as a consequence of a direct gift under a will of the deceased transferor, or by way of deed of variation or by way of appointment under the terms of the settlement made by the will) to secure that the property is vested in the spouse or civil partner of the deceased transferor thus extending the period of ownership in which the property may qualify – the transfer to the spouse or civil partner being an exempt transfer for IHT purposes.

Periods of ownership – business and interests in a business

So long as the business has been carried on for the requisite period of two years changes in the assets deployed in the course of that business should be disregarded.

Periods of ownership – shares and securities

First, shares or securities which are identified for the purposes of capital gains tax with the 'old holding' under TCGA 1992, ss 126 to 136 (dealing amongst other things with reorganisations, reconstructions and takeovers) are to be treated as the same shares or securities.

The extension of relief to shares and securities acquired on a reorganisation or takeover within two years of a death or gift of the shares or securities provides potentially useful opportunities for estate planning not open to the owners of businesses not involving a company. In that case, directors' loan accounts were discharged by the issue of shares to the members of company on a rights' issue.

Those new shares qualified for business property relief. By contrast, other new shares issued only to the deceased some two days before her death did not qualify because they involved no 'reorganisation' of the capital of the company for CGT purposes.

Does the company in which the shares or securities are held have to satisfy the condition that the business of the company should not consist wholly or mainly of making or holding investments (or the other disqualifying activities in s 105(3)) for the whole period of two years prior to the event giving rise to the charge?

At first sight, ownership of the shares for the requisite period of two years will satisfy the conditions notwithstanding that the company was not during the whole period of two years carrying on activity which is without the disqualifying terms of s 105(3).

Nonetheless, caution is needed. The test in s 105(3) is a factual one.

HMRC or the Special Commissioner on an appeal will, in determining whether the business of the company – at the moment of death or other chargeable event – consists wholly or mainly of making or holding investments (for example) are entitled to consider the track record of the company over a period of time.

If the trade or other business of the company which did not fall within the disqualifying activities was commenced within a relatively short period before the occasion for charge, HMRC or the Special Commissioners on appeal are entitled to find that the business consisted wholly or mainly of making or holding investments notwithstanding that at the time of charge it was beginning to assume some other character outside of s 105(3).

From an article by Robert Argles writing in Taxatio, February 2009

R&C Commissioners v Trustees of the Nelson Dance Family

The Inheritance Tax Act 1984, so far as material, provides: '3(1) Subject to the following provisions of this Part of this Act, a transfer of value is a disposition made by a person (the transferor) as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition; and the amount by which it is less is the value transferred by the transfer… 104(1) Where the whole or part of the value transferred by a transfer of value is attributable to the value of any relevant business property, the whole or that part of the value transferred shall be treated as reduced—(a) in the case of property falling within section 105(1)(a) (b) or (bb) below, by 100 per cent; (b) in the case of other relevant business property, by 50 per cent;… (2) For the purposes of this section, the value transferred by a transfer of value shall be calculated as a value on which no tax is chargeable … 105(1) Subject to the following provisions of this section and to sections 106, 108, 112(3) and 113 below, in this Chapter "relevant business property" means, in relation to any transfer of value,–(a) property consisting of a business or interest in a business;… 110 For the purposes of this Chapter—(a) the value of a business or of an interest in a business shall be taken to be its net value;(b) the net value of a business is the value of the assets used in the business (including goodwill) reduced by the aggregate amount of any liabilities incurred for the purposes of the business;… 112(1) In determining for the purposes of this Chapter what part of the value transferred by a transfer of value is attributable to the value of any relevant business property so much of the last-mentioned value as is attributable to any excepted assets within the meaning of subsection (2) below shall be left out of account.'

The deceased owned and carried on a farm business as a sole trader. The assets of the business included land and buildings. The deceased executed a family settlement (the settlement) upon discretionary trusts and, sometime in late 2002 or early 2003, executed two declarations of trust by virtue of which certain agricultural land and buildings, which had formed part of the business, became held on trusts of the settlement. The declarations of trust gave rise to a transfer of value as defined in s 3 of the Inheritance Tax Act 1984 (ITA 1984). The transfer of value did not, however, include a transfer of the business or an interest in the business to the trustees. The land had development value, so the trustees of the settlement claimed business property relief (BPR) under s 104 of the ITA 1984 in relation to the value of the land over and above its agricultural value. In April 2007, the Revenue and Custom Commissioners (the Revenue) issued a notice of determination to the effect that none of the value transferred was attributable to the value of the business property, and therefore, BPR was not applicable. The trustees appealed to the Special Commissioner against that determination. He ruled in favour of the trustees on the preliminary issue as to whether the transfer of relevant property into the hands of the trustees qualified for BPR, and accordingly, the determination of the Revenue was quashed. The Revenue appealed.

The preliminary issue was whether, on the facts agreed, the transfer of value associated with the creation of the settlement qualified for BPR under s 104 of the ITA 1984.

The court ruled that it was sufficient for the operation of s 104 of the ITA 1984, that a possible and proper characterisation of the attribution of the value transferred, was that it could be regarded as attributable to the value of a business. Section 104 of the ITA 1984 did not require an exclusive type of characterisation. Accordingly, it did not matter that the attribution could be to the value of land transferred, provided it could be said that the attribution could also be to the value of a business (see [18], [22], of the judgment).

That interpretation of s 104 of the ITA 1984 had the benefit of simplicity and certainty, and involved a direct cross-reference to the test in s 110 of the ITA 1984 to determine whether the value transferred was attributable to the value of the business. It was also in line with the general loss to donor principle in s 103 of the ITA 1984, which governed the operation of the ITA 1984, and the basic approach of the Act that any charge to tax did not turn upon what happened to property when it was in the hands of the transferee. Further, s 112(1) of ITA 1984 contemplated that the value of particular assets could be attributable to 'relevant business property' and also attributable to the assets themselves. Other instances for the application of BPR contemplated by s 105(1) of the ITA 1984 accorded with that interpretation of s 104 of ITA 1984, in that the issue in each case was whether the value of the transferor's relevant business property decreased as a result of the transfer in value, not the value of the assets transferred viewed in isolation (see [23], [25], [27], [28] of the judgment).

In the instant case, since the land had, before the transfer, been an asset used in the farming business, a possible and proper characterisation of the attribution of the value transferred was that it could be regarded as attributable to the value of the business, which was relevant business property for the purposes of s 104 of the ITA 1984. Accordingly, BPR was available on the transfer (see [22], [39] of the judgment).

The appeal would be dismissed.

Administration

What is 'reasonable care'?

This article considers inaccuracies due to carelessness, and in particular the concept of 'reasonable care' in the context of the new penalty regime that will apply to returns for certain taxes submitted after 1 April 2009.

Inaccuracies due to carelessness will attract a penalty up to 30% of the potential lost revenue. Deliberate inaccuracies will attract penalties up to 100% of the potential lost tax, depending on whether they were concealed or not.

The law

An inaccuracy will be 'careless' if it is because of a failure, by the person giving HMRC the inaccurate document, to take reasonable care (FA 2007, Sch 24 para 3(1)(a)).

HMRC say that 'it is simply a question of examining what the person did or failed to do and asking whether a prudent and reasonable person would have done that or failed to do that in those circumstances'.

Reasonable care cannot be identified without consideration of the particular person's abilities and circumstances. They say that they will not expect the same level of knowledge or expertise from a self-employed unrepresented individual as they will from a large multinational company.

Some examples are given in their *Compliance Handbook Manual* (see para CH81142) which illustrate HMRC's view of what amounts to a failure to take reasonable care and what does not, and the point is made that not all mistakes will be careless.

Reasonable care in practice

The starting point for considering the extent of the obligation to exercise reasonable care will be HMRC's interpretation of the standard to be applied to the particular taxpayer.

Inspectors are required to seek 'to establish whether the person has taken the care and attention that could be expected from a reasonable person taking reasonable care in similar circumstances'.

HMRC say, in essence, that a taxpayer should not be considered careless if:

- it holds a reasonably arguable view which is later not upheld; or
- it has made an arithmetical or transposition inaccuracy which is not so big as to produce an obviously odd result; or
- it follows advice from HMRC or a competent adviser which turns out to be wrong; or
- appropriate arrangements or systems exist which could reasonably be expected to produce an accurate calculation of tax but which fail, resulting in a mis-statement of tax which is not significant in relation to the taxpayer's overall liability.

The standing of guidance

The legislative worth of statements in HMRC manuals or guidance has recently been reviewed in the Special Commissioners' 2008 decision in Chilcott (SpC 727).

'HMRC manuals and HMRC guidance cannot be used as aids to statutory construction. They represent HMRC's interpretation of legislation and practice, and do not have any form of quasi-legislative status. To ascertain parliamentary intention, the principal method is to follow normal methods of statutory construction.'

So, the fact that a taxpayer's circumstances might be identical to those identified in the Compliance Handbook as being careful, would not prevent HMRC arguing to the contrary; nor would it bind a tribunal.

Burden of proof

The burden of proof falls on HMRC rather than the taxpayer

However, evidence will be given on both sides, HMRC will make out a prima facie case that the taxpayer has been careless, and the burden will then shift to the taxpayer to show that it has not, and the taxpayer will need to adduce evidence to that effect.

Compliance Handbook para 81180 tells HMRC officials that:

> 'It is for you to show, based on the evidence gathered, that a document contains a careless or deliberate inaccuracy.
>
> 'You should tell the person that they are liable to a penalty as soon as you become aware of it, even if you have not yet established the seriousness of the behaviour that gave rise to the penalty.'

If HMRC officials follow this guidance, the number of penalty assessments which are raised without prima facie evidence of carelessness should be reduced.

Standard of proof

This is the civil standard of proof, i.e. the balance of probabilities which means that it is for HMRC to prove that it is more probable than not that the inaccuracy was careless.

Evidence

The taxpayer will need to find somebody who can testify as to what is 'market practice' vis à vis the checks and balances that are being carried out in the area of business with which he is concerned.

At a level below giving evidence, there is a role of trade organisations, and tax groups, such as the VAT Practitioners Group and the Stamp Tax Practitioners Group, to help by providing market intelligence about what people are doing regarding market practice, so that when HMRC first enquire and suggest carelessness, there is some (albeit anecdotal) evidence about what other people do.

If push comes to shove, however, and the matter is contested, an expert will be required. This may be a growth area for industry specialists setting themselves up as experts, able to testify, on a non-attributable basis as to what similar businesses to the taxpayers are doing or not doing in circumstances similar to those in which the taxpayer finds itself.

From an article by Nigel Popplewell writing in Taxation, February 2009

HMRC compliance checks from 1 April 2009

HMRC has published information on how it will carry out compliance checks (also known as enquiries, visits and inspections) from 1 April 2009. The changes relate to income tax, capital gains tax, VAT, PAYE, the construction industry scheme and corporation tax.

The way HM Revenue & Customs (HMRC) carries out compliance checks (also known as enquiries, visits and inspections) will change from 1 April 2009. These changes will affect how we manage compliance checks for—

- Income Tax
- Capital Gains Tax
- VAT
- PAYE
- the Construction Industry Scheme
- Corporation Tax

The new compliance checks legislation is designed to make the tax system simpler and more consistent.

From 1 April 2009, HMRC will have one set of powers covering PAYE, VAT, Income Tax, Capital Gains Tax, Corporation Tax and Construction Industry Scheme to—

- visit businesses to inspect premises, assets and records
- ask taxpayers and third parties for more Information and documents

These powers are provided by Schedule 36 of the Finance Act 2008.

The new legislation will also provide—

- greater flexibility in setting record-keeping requirements after 1 April 2009
- new time limits for assessment and claims which will not be fully in force until April 2010–but there will be some transitional arrangements from 1 April 2009
- important safeguards for customers

These measures are provided by Schedule 37 and Schedule 39 of the Finance Act 2008.

Find out how the changes will affect you

We have published an e-learning package to help you understand our new framework for compliance checks.

The module, which has been rolled out to HMRC staff, takes less than half an hour to complete and provides an overview of the new framework.

It will help you understand the measures brought in by the Finance Act 2008 and how these will change the way HMRC officers check the tax position of individuals, companies and VAT-registered bodies.

Use the new compliance checks e-learning package (www.hmrc.gov.uk/e-learning/compliance-checks/Externalmodule/HTML/Externalmodule_menu.html)

Legislative changes at a glance

The new legislation provides HMRC with—

- one set of powers to inspect business records, assets and premises
- the ability to see statutory business records without a right of appeal
- the ability to look at records for PAYE, Income Tax, the Construction Industry Scheme, Capital Gains Tax and Corporation Tax during the tax year before a return has been submitted
- a new power to correct obvious errors in a tax return based on information held by HMRC
- a single approach across all taxes to asking taxpayers and third parties for supplementary information, based on formal information notices with a right of appeal

The legislation also makes some changes to the way HMRC must carry out compliance checks, including

- a new four-year time limit for assessments and claims–a reduction from six years for Income Tax, Capital Gains Tax and Corporation Tax and an increase from three years for VAT
- reductions in extended assessment time limits
- a streamlined process for closing Corporation Tax assessments
- a new statutory ban on inspecting purely private dwellings without consent
- a statutory requirement for HMRC to give at least seven days prior notice of a visit, unless either an unannounced visit is necessary, or a shorter period is agreed
- a new requirement that unannounced visits must be approved beforehand by a specially trained HMRC officer
- a statutory requirement on HMRC to act reasonably

Information for tax agents and advisers

You can find out more about managing compliance checks, penalties and appeals in the Tax agents and advisers area of the HMRC website.

Handling penalties, enquiries, appeals and tribunals for your clients (www.hmrc.gov.uk/agents/compliance.htm)

Update to the regional Working Together events–Finance Act 2008–compliance checks (www.hmrc.gov.uk/agents/comp-check-update.htm)

More useful links

You can download a summary of the responses the Government received to its consultation document on A New Approach to Compliance Checks published on 17 May 2007. It is an extract from the new consultation document Modernising Powers, Deterrents and Safeguards.

A further consultation, impact assessment and draft legislation are also available–Compliance Checks—The Next Stage

New information and inspection powers under FA 2008 see *Simon's Taxes* **A6.301A**

MoJ Guidance Note 10 February 2009

HMRC decisions–what to do if you disagree–Factsheet HMRC1

HMRC has published a new factsheet setting out the procedure for appeals against HMRC tax decisions made on or after 1 April 2009, when the new independent tax tribunals become operational.

Disagreeing with an HMRC decision

This factsheet tells you what you can do if you do not agree with one of our tax decisions and about appealing to the independent tax tribunal. It applies to tax decisions made on or after 1 April 2009.

This factsheet relates to tax decisions. If your decision relates to—

- Tax Credits you should go to www.hmrc.gov.uk/taxcredits/appealing.htm
- Child Benefit you should go to www.hmrc.gov.uk/childbenefit/appealing.htm
- Child Trust Fund you should go to www.childtrustfund.gov.uk/
- restoration of seized goods, you should refer to Notice 12A.

Tell us now if you disagree

When we make a decision on your appeal we will write and tell you. We will also explain how we arrived at the decision and tell you about your appeal rights. If you do not agree with the decision, write and tell us straightaway, but in any event, within 30 days of the decision. In direct tax this is known as an “appeal to HMRC”.

You do not have to do this yourself. An accountant or other adviser can do this on your behalf.

If you have further information or you think we have missed something, please tell us. If you do—

- we will tell you if this information changes our decision, or
- if it does not change our decision, we will explain why.

We find that most disagreements are resolved by discussing them with us.

What to do if we cannot reach agreement

If you are not satisfied with the outcome of our discussions you can—

- have your case reviewed by a different officer from the one who made the decision, or
- you can have your case heard by an independent tax tribunal.

If you opt to have your case reviewed you will still be able to appeal to the tribunal if you disagree with the outcome.

How a review works

You can choose whether or not to have a review. Either—

- we will offer you a review (you will have 30 days to tell us if you want one), or
- if we have not offered you a review, you can ask us to carry one out at any stage during our discussion about the dispute.

If you tell us that you want a review we will complete it within 45 days unless we agree another time with you. Reviews are carried out by HMRC staff not previously involved in the matter that you are disputing. You will have a chance to provide further information about your case. You cannot ask the tribunal to hear your case until the time limit has expired or we have told you the outcome of the review.

Once the review is complete, we will write and tell you the outcome, and explain our reasons. (If we cannot complete our review within 45 days, or any time we agreed with you, we will write and tell you.) You then have 30 days to ask the tribunal to hear your case.

Appealing to the tribunal

If you do not want a review, or you do not agree with the review conclusion, you can appeal to a tribunal. The tribunal is independent and your case will be heard by independently appointed expert tax judges and/or panel members. The tribunal is administered by the Tribunals Service which is part of the Ministry of Justice.

To appeal to the tribunal you must normally write to the Tribunals Service within 30 days of our decision letter or, if you have opted for review, within 30 days of our letter telling you of the conclusions of our review either by—

- completing a Tribunals Service appeal form available from the Tribunals Service website
- phoning the Tribunals Service for a copy, or
- writing to the Tribunals Service.

We will provide the phone number, web and postal addresses for the Tribunals Service when they become available.

The Tribunals Service will either—

- arrange a hearing to decide your appeal, or
- in more straightforward cases, decide the appeal on the basis of information sent by you and us without the need for a hearing.

More information about tribunals and tribunal hearings is available from the Tribunals Service website.

If you want your case heard by the tribunal and it is a direct tax case, you must have appealed to HMRC first.

Payment of tax during reviews and appeals

If the decision is about a direct tax matter you can usually ask us to postpone part or all of the tax in dispute until the appeal is settled. Interest will continue to accrue on any unpaid tax that is found to be due when the appeal is settled.

If the decision relates to an indirect tax matter (except for Customs matters), we will not collect the disputed tax while we carry out a review of the decision. But normally you must pay the disputed tax before any appeal can be heard by the tribunal. If paying the tax would cause you hardship you may ask us not to collect it while the appeal is ongoing. If you think this applies to you, please tell us.

You can talk to us at any time about our decision, even if you have appealed to the tribunal.

Partnership Registration

HMRC have introduced a centralisation unit specifically for the set up of partnerships that is within the Central Agents Authorisation Team (CAAT) in Longbenton.

I want to register a new partnership and its members, or register a new partnership member of an existing partnership.

With effect from February 2009, the set up of partnerships and their members will be centralised.

Read more about partnerships (www.hmrc.gov.uk/partnerships/index.shtml)

A Partnership Return (SA800) requires a declaration of the name, residence and tax reference (Unique Taxpayer Reference–UTR) for each partner. An online Partnership return will fail validation and be rejected if the UTR for each and every partner has not been entered.

Substitute UTRs, such as 99999 99999 have been used by customers and HMRC staff in circumstances other than the exceptional situations they were designed for, such as for some non UK resident partners. We have decided therefore to introduce a centralisation unit specifically for the set up of partnerships and this will be effective from February 2009 within the Central Agents Authorisation Team (CAAT) in Longbenton.

From that date all partnerships and their members will be required to use a UTR that is exactly that, a Unique Taxpayer Reference that has been issued by HMRC. The use of substitute UTRs will no longer be acceptable. Our previously published guidance that a substitute UTR can be entered as a workaround is withdrawn with effect from 31 January 2009 because its continued use would undermine the benefits of centralised set up and our risk assessment process.

The centralisation unit in CAAT will respond to customer requests concerning the set up of a partnership and its members. This will include all trading and investment partnerships, whether a general partnership, limited liability partnership (LLP) or limited partnership (LP) and all it's members, whether they are individuals, companies or other entities, resident in the UK or outside the UK. HMRC's intranet guidance will be changed to reflect this. CWF1 form should be used to notify CAAT of the partnership and its members and should specify the nature of the partnership business—

- Download Form CWF1 (PDF 43K) (www.hmrc.gov.uk/forms/cwf1.pdf)

The centralisation unit will also respond in real time to partnership registrations at Companies House. These will be LLPs and LPs. This will enable the set-up of partnerships and the linkage of their members well in advance of filing obligation dates.

This centralised set up strategy for partnerships will enable our customers to file more accurately whether by paper return or electronically. It means that we treat our customers fairly in the risk assessment process.

From the 1 February 2009, the use of substitute UTRs means that the return is strictly incorrect and may result in the return being sent back to the sender following compliance action in order that the entry may be corrected. If the return is not corrected within the additional time allowed, late filing penalties may be imposed. HMRC must have the correct information to conduct a risk assessment of the partnership and its members; this risk assessment being a cornerstone of the ITSA process

Where a partner is a limited company, the tax reference to be entered on the Partnership Return for that individual corporate partner is the 10 digit Corporation Tax UTR.

Contact details for CAAT are—

CAA Team, Longbenton, Newcastle upon Tyne, NE98 1ZZ

HMRC Notice 10 February 2009

Business Tax

Employment status developments

ESI

A new release of the ESI tool was introduced on 11 December 2008.

Main developments are:

- Changes to the wording of some questions
- Additional clarifying question within the area of equipment and materials
- Clarification of those situations where the individual does not provide all of the materials or supplies directly to the client, but is paid an all-inclusive rate of income which covers the cost of the individual's provision of substantial materials needed for the work.

Case law

Decided tax cases have shown that there is no single matter to which reference can be had in distinguishing the self employed from the employed. In fact often tax cases have proved to be unhelpful outside of their own particular facts. However, the following tend to be relevant:

- the provision of service for remuneration
- control
- integration
- provision of equipment
- hiring of helpers/use of substitutes
- degree of financial risk
- responsibility for investment and management
- contract terms
- duration of engagements
- number of engagements
- mutuality
- dependence on, or independence of, a particular paymaster

Out of these factors it is arguable that only substitution (see *Express and Echo Publications Ltd v Ernest Tanton [1999] IRLR 367*) and mutuality would be a winning argument on its own. Usually it is a combination of several factors which determine the final result.

Recent cases

There are plenty of recent examples of HMRC struggling to re-classify an individual as an employee and/or whether IR35 applies where a limited company is used to provide services of an individual, but also evidence of a new approach of obtaining evidence of the realities of the arrangement from the end-user. That presumably followed the collapse and criticism of HMRC's approach in ***Lewis (t/a MAL Scaffolding) and others v HMRC (SpC 527)*** where the Special Commissioner noted at para 53 of his decision:

'*The commissioners appear to have approached their investigations on the basis that there must be an employment relationship between MAL Scaffolding and the workers there if one looks hard enough. Officers then went looking on that basis and persuaded themselves that they had found that for which they were looking. They have failed totally to persuade me.*'

Datagate Services Limited v HMRC SpC656

The Commissioner found that *"standing back and looking at the picture as a whole I find it a primary fact that he was in business on his own account and was not a person working as an*

employee in someone else's business on the hypothetical requirements that the legislation requires. He chose to do this through his company".

First Word Software Limited v HMRC SpC652

This was also won by the taxpayer, with the Commissioner considering the usual factors:

- SUBSTITUTION
- CONTROL
- MUTUALITY
- IN BUSINESS ON OWN ACCOUNT
- VOLUME OF WORK DONE AND OTHER FACTORS

Dragonfly Consulting Limited v HMRC High Court 3/9/08

This on the other hand was won by HMRC at Special Commissioner level, seemingly on the grounds that the evidence provided by the end-client was convincing. Arguably more notice was taken by the Commissioner of that oral evidence than what the written contracts actually said. He concluded that substitution clauses are irrelevant if as in this case the end-client *"did not want just any competent tester, it wanted Mr Bessell".*

The taxpayer lost his appeal in the High Court as under:

1. Dragonfly Consultancy Ltd employed its owner, an IT consultant. Dragonfly contracted with an agency, which in turn had a contract to supply workers to an end client (the AA).
2. The Special Commissioners held that had the consultant been in a direct contractual relationship with that client it would have been an employment relationship. Therefore IR35 applied. Dragonfly appealed.
3. In dismissing the appeal the Court made some interesting comments. Firstly, it found that the Special Commissioners were entitled to find that the substitution clause in the consultant's notional contract with the client would not have been such as to preclude an employment relationship. The substitution clause retained the right for the client to reject substitutes. The High Court also held that the Special Commissioners were entitled on the facts to hold that the degree of control exercised by the end client equated to that under an employment contract and the taxpayer had not provided sufficient evidence otherwise.

MKM Computing Limited v HMRC SpC653

This was also won by HMRC largely based on oral evidence given by the end-client as opposed to what the contracts said.

Castle Construction (Chesterfield) Limited v HMRC SpC723

The commissioner said the case was straightforward and confirmed self-employment status to certain bricklayers by reference to the following facts:

- Some bricklayers were employed permanently (no dispute as to their status of course), but they could be distinguished from workers hired and terminated with complete flexibility which suited the company and its ever-fluctuating workload.
- The flexibility was demonstrated by the fact that in the year the company had given work to 450 bricklayers but had they been employed the same amount of work could have been done by 150 people.
- The individuals were paid only for hours worked – not per brick as difficult to calculate how to pay them on that basis.
- No pay if weather conditions prevented them from working, and no holiday pay or sick pay.
- Hourly-rate was considerably higher than the full-time employees received.
- HMRC's view was that it was significant that the contract referred to the company as the employer. Held that did not matter as (a) it is merely the term used to denote the appellant,

and (b) more significantly, there is no non-legalistic word to describe the principal in a principal/subcontractor relationship.

- HMRC also argued that as the individuals were expected to give a week's notice of their intention to take time off for holidays, this implied employment. Held that the notice period was not due to an employment relationship, but rather as a means of ensuring the smooth running of the business so that the right number of people would be on site the following week.
- The individuals had to wear protective vests with the company logo, as did the employees, but the former had to pay for them.
- Another distinction between the individuals and the employees was that the former were not provided with transport to and from site, unlike the employees.

Article by Gerry Hart

Lecture B521 (11.20 Minutes)

Corporation Tax

Corporation tax regime for small companies

Effective corporation tax rates on profit bands

Profits	*Year to 31/3/09 (fy 2008)*	*Year to 31/3/10 (fy 2009)*	*Year to 31/3/11 (fy 2010)*
first £300,000	*21%*	*21%*	*22%*
next £1,200,000	*29.21%*	*?*	
over £1,500,000	*28%*	*?*	

Distributing profits to a 40% taxpayer – total cost of earnings vs dividends

CT rate	*Earnings to UEL*	*Earnings above UEL*	*Dividend*
21%	*56.56%*	*47.7%*	*40.75%*
22%	*56.56%*	*47.7%*	*41.49%*
28%	*56.56%*	*47.7%*	*46%*

Associated companies

This of course can result in far less than £300,000 of profits enjoying the 21% rate. The concerted attack by HMRC in cases where the existence of an associated company may not be known or anticipated (the prime example involves an LLP used for a film scheme) has now collapsed following FA 2008, although they do not cover other unfair examples of companies being associated. It is understood that there may be further relaxations in the pipeline.

From 1 April 2008 the rights and powers held by business partners are only attributed when relevant tax planning arrangements have at any time had effect in respect of the taxpayer company. That covers arrangements which involve the shareholder or director and the partner, and secure a tax advantage because of greater small companies relief.

A new venture could be set up using a subsidiary LLP rather than a subsidiary company. The members will be the existing trading company plus some or all of its shareholders. Then, the trading company's share of profit of the LLP is treated as a branch of the company's business. Depending on the amounts involved, this could reduce the impact of the associated company provisions.

Simplification review of corporation tax calculations and returns for smaller companies

This discussion document was issued in November 2008 and outlines some possible simplification measures. In developing any new regime, recent EU proposals on allowing member states to vary accounting requirements for "micro" companies from current accounting directives must be taken into account although it was said that they are likely to take "some time" to be considered.

The main possibilities are outlined below, but there was also a request made for any other possibilities to be raised:

STATUTORY ACCOUNTS PROFITS TO BE USED AS TAXABLE PROFITS

Accept unadjusted accounts, prepared in accordance with UK GAAP, as the basis of taxable profits. This was said to not be feasible given, for example, the AIA available for tax purposes.

FLAT RATE TAX ALLOWANCES

Expenses would be allowed at a flat rate for all similar businesses. This was dismissed as an impractical option given the extremely wide variation in the ratio of expenses to turnover.

ALIGN CURRENT STATUTORY ACCOUNTING AND TAX CALCULATION OBLIGATIONS INTO A NEW ACCOUNTING STANDARD WHICH INCORPORATES TAX OBLIGATIONS

This is seen as a possibility, with the company's liability to corporation tax being the same as at present but the accounts being prepared under a new standard which determines the same profits as for tax.

CALCULATION OF TAX ON A CASH-FLOW BASIS

This could be introduced for the smallest of companies on a voluntary basis. However there are concerns, such as the loss of enhanced tax reliefs such as the AIA.

The taxable profit would simply be the company's actual receipts in the accounting period LESS allowable business expenditure actually paid.

It was stated that a cash-flow regime is not an option in the short term given the current requirement to produce statutory accounts using accruals accounting.

Article by Gerry Hart
Lecture B522 (9.00 Minutes)

HMRC's plan to give ESC C16 legislative effect

HMRC recently issued *Extra-statutory concessions: Technical consultation on draft legislation*, seeking views on the legislative effect that is being given to some concessions (see ESCs to be legislated).

Recent developments

The consultation document divides the existing ESCs between:

- those that can be legislated under s 160 FA 2008 (or other powers);
- concessions that can remain as such because they are considered 'intra vires', i.e. within HMRC's discretionary powers and are linked to other ESCs in the s 160 category; and
- those where 'clarification' is needed before legislation is drafted; this includes ESC C16

Extra-statutory concession C16

Broadly, this allows distributions to shareholders on the dissolution of a company to be treated as capital distributions within TCGA 1992, s 122, as opposed to income distributions within TA 1988, s 209, if certain conditions are satisfied and assurances are given to HMRC.

Additional conditions

Two additional conditions are listed in HMRC's *Company Taxation Manual* (at CTM36220).

1. Company must not be the subject of an investigation
2. Broadly that the company is not potentially 'caught' by the transactions in securities anti-avoidance provisions of ITA 2007, s 684 (formerly TA 1988, s 703) in respect of the following (listed under sub-paragraphs (e) or (f) of CTM36875, but paraphrased below):
   - transfers or sales of the company's assets or business to another company with some or all of the same shareholders followed by the liquidation of the former company or the sale of shares in either company;
   - capital receipts by the company's (or group's) shareholders following a demerger or reconstruction from the sale or liquidation of one demerged company where the same shareholders retain an interest via another company involved in the transactions.

HMRC officers should not automatically refuse to apply ESC C16 if the company and its shareholders fail to meet all the relevant conditions. They should instead refer the matter to their technical specialist colleagues for further consideration.

Practical issue

A further practical issue is what happens if the company has already made distributions as part of the dissolution process, without having sought HMRC's prior approval to apply ESC C16.

I recently dealt with such a case and having pointed out that HMRC's own guidance allows for concessionary treatment even after a company has been dissolved (CTM36230), the HMRC officer applied ESC C16 with retrospective effect.

Why might ESC C16 be preferable?

It is intended to benefit companies and owners by saving costs associated with a formal winding up.

In addition, potentially lower rates of capital gains tax in recent years; business asset taper relief, where it was available prior to 6 April 2008 and the single 18% rate in the current tax year reduced by entrepreneurs' relief, if applicable, means that capital distributions are very often more attractive to the company's shareholders than those liable to income tax.

Problems with ESC C16

The ESC C16 process typically involves the distribution of a company's assets, including the repayment of its share capital represented by those assets.

For company law purposes, a distribution does not include the repayment of paid-up share capital, or a distribution of company assets to its members on its winding up (CA 2006, s 829(2)).

A problem with ESC C16, as highlighted in the *Wilkinson* case, is that it is a deeming provision for tax purposes but is unlawful in company law terms where the concession is applied.

A further problem with ESC C16 is that in the absence of a winding up, the company's share capital, and any other property and rights still held not repaid or transferred prior to dissolution are strictly 'bona vacantia' and become assets of the Crown, Duchy of Lancaster or the Duke of Cornwall.

However, in practice the Bona Vacantia division of the Treasury Solicitor's department will allow up to £4,000 to be repaid without seeking recovery as an unauthorised distribution (see form BVC 17, *Guidelines about the distribution of a company's share capital,* on the Bona Vacantia website).

Reducing share capital

What if the company's share capital exceeds £4,000?

Since 1 October 2008, private limited companies have been able to reduce their share capital, using a solvency statement procedure introduced in Companies Act 2006 (ss 642 to 644) and supporting Regulations (The Companies (Reduction of Share Capital) Order, SI 2008 No 1915).

The company can reduce its capital in any way it chooses, including repaying share capital in excess of the company's 'wants'.

However, there are certain conditions attached to the capital reduction procedure.

- There must be at least one member holding a non-redeemable share following the reduction
- The procedure must be permitted in the company's memorandum or articles
- The company's directors must make a solvency statement up to 15 days before the passing of the special resolution.
- A copy of the solvency statement and resolution, and the memorandum concerning the company's share capital and directors' compliance statement, must be delivered to Companies House within 15 days of the resolution to reduce the company's share capital being passed.

Capital reductions and C16

While repaid share capital can potentially be treated as a capital distribution for tax purposes, the capital reduction provisions do not seemingly affect the position regarding a company's accumulated realised profits.

Their distribution remains subject to income tax in the hands of individual shareholders, subject to a formal winding up, or to the application of ESC C16.

Nevertheless, the solvency statement procedure followed by an application for ESC C16 treatment may be useful where, for example, the company's share capital exceeds the £4,000 limit for bona vacantia purposes.

In appropriate circumstances, it may be possible to reduce share capital to within the Treasury Solicitor's tolerance limit. The remaining share capital could then be repaid as part of the ESC C16 process.

A 'capital distribution' for capital gains purposes includes a distribution in money or money's worth during the course of dissolving or winding up a company, unless the distribution constitutes income in the shareholder's hands (TCGA 1992, s 122(1), (5)).

Capital distributions by companies to shareholders during a winding up, whether under ESC C16 or in a formal liquidation, are not normally treated as income payments, but as full or part disposals for the purposes of capital gains tax or corporation tax on chargeable gains.

Reductions in share capital under the new solvency statement procedure also generally fall to be treated as capital distributions to the shareholder.

Legislating for C16

HMRC's technical consultation included ECS C16 in a category of concessions for which clarification is needed before legislation is drafted.

The department is understood to be preparing an external briefing paper explaining where clarification is required. The briefing paper was due to be released shortly after the time of writing this article.

It would be interesting to see if HMRC address the conflict between ESC C16 and company law in connection with distributions representing share capital made otherwise than in a formal winding up of the company.

However, it seems more likely that the concession will simply be added to the tax legislation in some form, and perhaps that the exclusion from the meaning of 'distribution' in TA 1988, s 209(1) will be extended to include distributions in the course of the voluntary striking off of a company.

What will happen to the assurances which are presently required to be given to HMRC as part of the ESC C16 application, and how legislative effect will be given to that process, remains to be seen.

From an article by Mark McLaughlin writing in Taxation, February 2009

Lecture B523 (12.54 Minutes)

Dividend waivers – watch out!

The decision in *Buck v HMRC (2008)* examined the question of whether a dividend waiver can constitute a settlement for income tax purposes under what is now Ss624 – 625 ITTOIA 2005.

Buck v HMRC

Mr Buck owned 9,999 shares in a family trading company and the remaining share was held by his wife. Shortly before the company's year ended 31 March 1999, Mr Buck waived his dividend entitlement by formal notice in writing and a dividend of £35,000 per share for that year was then paid out, all of which went to Mrs Buck. They did the same for the following year.

HMRC's argument

HMRC argued that the two dividend waivers in 1999 and 2000 and the subsequent payments to Mrs Buck represented an arrangement for the purposes of S620 ITTOIA 2005 so that the anti-avoidance settlement legislation applied. They considered that the let-out in S626 ITTOIA 2005 was not in point, given that the arrangement did not represent an outright gift of income-producing property from one spouse to the other and, in any event, the subject-matter of the gift was wholly a right to income. The taxpayer (who was unrepresented and did not attend the hearing) claimed that there was no arrangement – it was in the company's interest to pay out the maximum dividends available and he had not wanted to receive them.

Unsurprisingly, the Special Commissioners found HMRC's arguments convincing, with the result that the waived dividends were treated as Mr Buck's income and so were taxable on him.

When would the settlements legislation not apply?

It has always been thought that a dividend waiver can be a settlement, provided, of course, that the necessary element of bounty is present. This is certainly the case where the waiver enables another shareholder to receive an increased dividend.

However, with dividend waivers, this will not always be the position.

A dividend waiver has been described by one commentator as 'the abandonment of a contingent right so that the relevant shareholder does not receive the dividend'. That does not necessarily mean that anyone else receives more. It will do so if a dividend is proposed of a fixed monetary amount and one shareholder waives his entitlement – in that case, the whole of the fixed sum will then go to the remaining shareholders and they will receive more than they otherwise would. That would represent bounty and the settlement provisions could of course apply.

However, if a dividend is proposed of a fixed amount per share, the fact that one shareholder waives his entitlement does not increase the amounts payable to the others. In those circumstances, there can be no bounty and no settlement.

Why the Bucks failed

But it is important not to try to be too clever because, as happened with Mr Buck, if a dividend per share is proposed which is manifestly in excess of the company's distributable profits, the whole arrangement will be a settlement. The amounts payable to the other shareholders will only be possible because the proposed dividend will have been made in the clear knowledge that the waiver would take place.

One cannot take exception to a shareholder receiving a dividend on his or her shares if no-one else receives a corresponding dividend. Where HMRC are likely to become interested is if arrangements are made whereby, say, a 30% shareholder receives more than 30% of the company's distributable profits. In this situation, HMRC will undoubtedly try to invoke the settlement legislation.

The recent provisions on income shifting may have been quietly dropped, but Ss624 – 625 ITTOIA 2005 are still a powerful weapon in the hands of HMRC.

Article by Robert Jamieson

Lecture B524 (9.24 Minutes)

Value Added Tax

Supplies and consideration

This article considers several recent developments in the area of supplies and consideration. These are:

- a statement from HMRC accepting that sometimes penalties for breaching a contract are not consideration for a supply and are therefore outside the scope of VAT;
- a case about payments by a local authority to a charity where it was held that these were VATable consideration for a supply of services, rather than a mere grant to the charity which would be outside the scope of VAT;
- a case about an arrangement between a school and a sports centre which held that the parties were bartering services in return for land, so there was an increase in the values that would be subject to VAT over and above the obvious cash consideration for the lease;
- a case about an agency arrangement which a company thought it was operating in order to save VAT, but which was held not to work in the way the company thought – with disastrous results.

Car parking charges

HMRC have issued a Brief explaining that they have changed their view of the VAT liability of some penalty charges levied by car park operators. Previously they believed that all payments by those parking cars would be VATable. Now they accept that some payments are not consideration for parking the vehicle but are rather penalties for breach of contract, which are outside the scope.

HMRC draw a distinction between:

- charges which reflect extra consideration for extra time, for example where the “penalty” for exceeding time paid for is clearly displayed at the time the vehicle is parked; and
- charges which are purely a penalty, for example for parking in a disabled bay without proper authority, parking across the lines of bays, and not displaying a ticket.

Where a car park operator has accounted for VAT on such charges, a claim for repayment can be made, subject to the three-year cap and a possible unjust enrichment argument (although it is not clear how that would apply to penalties, where there can hardly be a “market rate” – the customer does not intend to pay them).

HMRC make the interesting observation that some car park owners allow sub-contract operators to keep any penalty charges. In that case, HMRC believe that the payments are VATable consideration within the contract between the landowner and the operator, rather than being outside the scope. It may be possible to argue that there should be a repayment of VAT to the landowner, because:

- the customer has paid an amount which should not be subject to VAT;
- presumably the landowner is entitled to it in the first instance, and allows the operator to keep it;
- it is therefore collected by the operator as agent for the landowner, and then retained by the operator as consideration within the contract.

As HMRC have said that the receipt does not give rise to a repayment, anyone wishing to argue this line will need to go to the Tribunal.

R & C Brief 57/08

Consideration or grant?

Bath and North East Somerset Council made substantial payments to a charitable trust company for organising the Bath International Music Festival. It claimed that the money was consideration for supplies of services, so it would be entitled to recover input tax in relation to the costs of organising the festival. HMRC ruled that the money constituted a grant which was outside the scope of VAT.

Under the Local Government Act 2000, local authorities have the power to "promote the social well-being of their area". Presumably, if this constituted a supply of services to the local authority, it would be able to recover the VAT charged to it because it was exercising this statutory power in arranging for the festival to take place. The arrangements between the council and the trust dated back to the 1990s. The activities covered by the two disputed rulings were governed by agreements made between the council and the trust in 2000 and in 2006.

The Tribunal examined the agreements in detail and concluded that the trust made supplies for consideration. Although the amounts paid were "round sums" which did not cover more than a quarter of the costs of the trust, and were not allocated to specific parts of the festival, nevertheless the written contracts imposed certain obligations on the trust in respect of service levels. The cases of *Hillingdon Legal Resources Centre* and *Wolverhampton Citizens Advice Bureau* were distinguished and the case of *Edinburgh Leisure* was followed. The payments represented consideration for supplies of taxable services.

VAT Tribunal (20,840): *Bath Festivals Trust Ltd*

Barter

A school granted a lease over some sports fields to a partnership which operated a commercial sports centre. The school received a peppercorn rent and the right to use the facilities at certain times. The partnership later transferred its business to a company, which took an assignment of the lease and continued to make the facilities available to the school in accordance with the earlier agreement.

HMRC assessed the company for output tax on the basis that there was a barter transaction with the school: the company was providing taxable facilities in return for an exempt licence to occupy land. The company appealed, contending either that there was no barter transaction at all, or that the valuation put on the barter by HMRC was excessive.

The partnership had rented the land from the school since 1988, but there was little evidence about the original arrangements between the parties. The current lease, which was entered into in 2002, provided that "*The tenant will permit the Landlord including their agents employees and members of Kings School Gloucester access to the facilities at the Premises on the terms and in the manner set out in the Seventh Schedule*". The Seventh Schedule provided that "*The Tenant grants the Landlord (which expression shall include their agents employees (but in respect of employees to no more than 30 in any one year) and members of Kings School Gloucester) rights to use the sports facilities at the Premises at no cost on the following terms (or such other terms as shall be agreed or substituted between the Landlord and the Tenant (acting reasonably)*". The terms included offer of discounts on membership to the school's employees/pupils who wanted to use the facilities independently.

The appellants argued that these clauses represented something reserved to the landlord (or "carved out") as part of the creation of the lease. The Tribunal agreed with HMRC that the proper analysis was to regard them as consideration for the grant of the lease. The lease represented an interest in the whole of the premises without anything being reserved back to the landlord.

It was relevant that the school appeared to have the legal right to the whole building when the lease expired in 2002, so to grant a lease at a peppercorn rental to someone who could then run a commercial leisure centre and make profits of £250,000 a year would be an illogical thing to do.

The Tribunal then commented on the basis on which the consideration should be valued. The chairman agreed with HMRC that the way to approach the question was to consider the price that the school would otherwise have had to pay for using the facilities, as in the case of *Westmorland Motorway Services Ltd*; but he considered that the comparable prices would be the discounted rates for a corporate membership, rather than the normal rates payable by members of the public.

The value was not the ground rent that the school could have charged to the company. Although it was likely that the two figures ought to be comparable, the authorities show that where there are prices for the services which are charged to third parties, those prices are the basis for an "agreed valuation" for the supply of barter.

VAT Tribunal (20,848): *Riverside Sports & Leisure Ltd*

LexisNexis® Tolley

Client account

A company appeared to have set up its whole business structure based on VAT advice. As the Tribunal confirmed assessments for more than £1.2m covering the periods July 2002 to November 2004, this advice appears to have been flawed.

It was common ground that a company which supplies "loft conversion services" to a customer must charge VAT on the whole of what the customer pays, when the customer pays it. The companies in this case argued that they provided "project management services". They received money from the customer and put it in a client account. It would then be taken out of the client account:

- to pay the project manager's fees, which were included in the companies' VAT returns, company accounts and corporation tax computations;
- to pay the costs of the project, which were regarded as disbursements of the client's money and therefore not part of the companies' accounts at all.

At the end of a project, some money was retained within the client account to cover the possible cost of claims under a ten-year guarantee. That part of the client's payment would not be subject to VAT until much later when it was released to the project manager.

The company director claimed that the company's contracts reflected the intended arrangements. The company arranged contracts between the various suppliers – designers, plumbers, electricians, plasterers, and so on – and the clients. The contracts should determine the nature of the supply unless they were a sham, which they were not.

The Tribunal took evidence from a number of witnesses, including a client and some tradesmen. Although the fine print attempted to create the contracts that the director contended for, it seemed unlikely that anyone else understood that to be the case. In particular, the client – who was a friend of the director and presumably was trying to support his case – did not believe that he had a contract with each of the individual tradesmen. If there had been a problem, he would have expected the company to put it right. As a result, the company was supplying the loft conversion service and it was liable to output tax on all its receipts. It is perhaps surprising that there was no mention of a misdeclaration penalty in the case, because the numbers are so large that it would appear inevitable that s.63 would be in point.

VAT Tribunal (20,888): *A1 Lofts Ltd & A1 Loft Conversions Ltd*

Article by Mike Thexton

Lecture B525 (23.42 Minutes)

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