

The fundamental principles of PCRT (Lecture B1335 – 22.46 minutes)

The fundamental principle which underpins the document is that the profession has got to display ethical behavior and those who do not behave ethically are negatively impacting the profession as a whole.

The Professional Conduct in Relation to Taxation (PCRT) is a guide to members as to how they behave. If a member of one of the professional bodies does not comply with these rules, then they will be subject to disciplinary processes.

If there is any doubt over the ethical or legal considerations of a particular case, then the person should seek advice from their professional body. These rules are in addition to the responsibilities that anyone within the profession has in relation to the anti-money laundering legislation as the two are separate.

There are five Principles and five Standards to be applied to tax planning. These are underpinned by helpsheets which are designed to give practical advice about the application of the rules but are not mandatory in the way that the Principles and Standards are.

It applies to all members of the profession who practice in tax including:

- employees;
- those dealing with the tax affairs of themselves, family, friends etc. whether or not for payment;
- those working for HMRC or other public sector organisations.

The following are the fundamental principles of the document:

Integrity

To be straightforward and honest in all professional and business relationships.

Objectivity

To not allow bias, conflict of interest or undue influence of others to override professional or business judgements.

Professional competence and due care

To maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.

Confidentiality

To respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the member or third parties.

Professional behaviour

To comply with relevant laws and regulations and avoid any action that discredits the profession.

We can look at these in more detail and will return to these when we look at some examples later on.

Integrity

You have to be honest in all dealings with clients, the tax authorities and other interested parties. The members must do nothing knowingly or carelessly that might mislead either by commission or omission. In reality the main problem here is likely to be omission through carelessness.

Let's take an example of a client who has entered into a joint venture agreement with a business partner who has a separate adviser. That adviser has come up with an idea to mitigate the tax liability for the joint venture and your client has been provided with a copy of the advice. You look up the other adviser on LinkedIn and he seems to be a legitimate adviser. You are short of time and under pressure from the client and so you agree the planning works without really looking at it in detail.

If it turns out the planning is not sustainable, there is an argument to say that you have been dishonest in your dealings with your client through failing to adequately consider the planning. You have not protected them from the potential fall-out from the planning going wrong.

Another example might be where you have an issue where the tax treatment is unclear but the amounts involved are quite small and you are confident that information can be presented such that HMRC will not pick up the issue. This could be called 'tax planning on the basis that HMRC don't notice what you have done'. That again could lead to claims that you have not acted with integrity.

Objectivity

This is an easier one to discuss in many ways as we have evidence of how this has played out in the past. As the guidance states 'relationships which bias or unduly influence the professional judgement of the member must be avoided'. There have been many tax planning businesses in the past who have promoted schemes through accountants who have been given generous commissions for referrals – this happened a lot with EBT type planning. Many (although not all) of those accountants may have been disinclined to study the detail of those schemes when they could see the benefits they were deriving from their clients' involvement.

The PCRT is now explicit that a member must always disclose to their client if they are receiving commission, incentives or other advantages (and the amount of such) relating to any matter upon which they are advising their clients.

Professional competence and due care

This falls into two categories: the member must have the requisite skill to provide the advice that they are giving and the work must not stray beyond the terms of the engagement.

This latter one brings us to the first point at which we have to remind ourselves that part of the PCRT is to protect the advisers themselves. Work outside the scope of an engagement may not be covered by the professional indemnity insurance.

It is the author's view that this is an area where there is a huge issue within the profession. You only need to consider the experience of working on a free tax helpline for one of the insurers (which I have done) to be horrified by the lack of knowledge of people phoning up and who are not prepared to pay to get proper advice for their clients. It is my own personal view that there are too many people within the profession who are advising on areas where they do not have the requisite skill.

The PCRT suggests that when giving a significant opinion on something then a client should consider obtaining a second opinion. Advice should always consider the context in which advice is given.

Of course, larger firms do have an advantage in this respect because they can have review structures to check advice is robust. This is not always as easy in smaller firms.

The PCRT notes that a member is free to choose whether to act for a client either generally or specifically but this does not acknowledge the difficulties in managing client relationships and the pressure to provide services in an increasingly competitive world.

Confidentiality

The duty of confidentiality is, of course, safeguarded in law. It is an express term in most contracts and would be implied if not present. Whilst there maybe circumstances when there is a legal or professional right or duty to disclose this needs to be rigorously monitored and only the minimum amount of information necessary to protect those interests may be disclosed.

This is discussed further below.

Professional behaviour

This is the one which causes, in many ways, the most controversy. It is easy to say that someone has acted 'unprofessionally' but it is difficult to define all of the actions which fall within that category. The PCRT makes it clear that a member who considers a proposed arrangement to be tax evasion must advise the client not to enter into them. If the client ignores the advice, it is likely the member would not continue to act for that client.

Disagreements with HMRC must be dealt with in an open, constructive and professional manner whilst robustly serving the clients' interests.

This is a really interesting one as many advisers will struggle to maintain professional behaviour in some dealings with HMRC. What do you do if HMRC are being, in your view, completely unreasonable? In a recent case involving an SDLT enquiry, the author was completely flummoxed by the attitude of the HMRC officer who appeared to be seeking 3 lots of SDLT on a single transaction based on a flawed interpretation of the legalities of the deal. His view had been comprehensively repudiated by a reputable barrister but he was still refusing to accept he was wrong. This certainly caused difficulties in maintaining professionalism. It was resolved in the end by writing of an incredibly strongly worded letter suggesting a complaint was going to be made about the behaviour. Unfortunately, this does not always work!

The standards for tax planning

Client Specific

Tax planning must be specific to the particular client's facts and circumstances. Clients must be alerted to the wider risks and the implications of any courses of action.

Lawful

At all times members must act lawfully and with integrity and expect the same from their clients. Tax planning should be based on a realistic assessment of the facts and on a credible view of the law. Members should draw their clients' attention to where the law is materially uncertain, for example because HMRC is known to take a different view of the law. Members should consider taking further advice appropriate to the risks and circumstances of the particular case, for example where litigation is likely.

Disclosure and transparency

Tax advice must not rely for its effectiveness on HMRC having less than the relevant facts. Any disclosure must fairly represent all relevant facts.

Tax planning arrangements

Members must not create, encourage or promote tax planning arrangements or structures that i) set out to achieve results that are contrary to the clear intention of Parliament in enacting relevant legislation and/or ii) are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation.

Professional judgement and appropriate documentation

Applying these requirements to particular client advisory situations requires members to exercise professional judgement on a number of matters. Members should keep notes on a timely basis of the rationale for the judgments exercised in seeking to adhere to these requirements.

Looking at the guidance to get some further pointers in relation to each of these leads the following comments being made but these are explored further below when we look at some examples.

Client specific

Generic advice gives rise to particular risks and should be avoided unless it is clear that it is generic (and would then normally include a disclaimer about this – it covers newsletters and similar). Whilst assumptions can be made when giving advice, these must be reasonable and realistic, and it should be clear when those assumptions impact on the advice so that there is little scope for misunderstandings to arise. Consideration should be given to including the impact of a change in the assumptions or the circumstances where it would be imperative to receive specific advice.

Lawful

Clients must be advised about material uncertainty in the law even if the practical likelihood of HMRC intervention is considered to be low.

Where the view of HMRC is uncertain or not known, this should be included as part of the advice; equally if the advisor disagrees with a stated HMRC view (and this is not, in itself, wrong) then the client should be told this and the risks/costs of adopting a contrary view.

Disclosure and transparency

Disclosure must be made where it is required by law and may be advised where it is appropriate to give a wider context to HMRC although the exact nature of any disclosure will be a matter of professional judgement.

Tax planning arrangements

Where there is genuine uncertainty as to whether particular planning is in breach of the standard, the member must document the reason why they believe the planning is not in breach; include in any advice that there is uncertainty and the risks this creates and include in any advice the relevant disclosures which must be made to HMRC.

Professional judgement and appropriate documentation

Notes and documents must be prepared and retained which support all judgements made and establishing compliance with all principles, sufficient to be utilized after the event if necessary. Again, it is suspected that this is an area where there is some complacency.

Examples

It is always very difficult to make definitive judgements about when the PCRT principles might need to be considered but here are some cases where there are issues to discuss.

A client, whose affairs are always slightly behind and disorganized, is routinely backdating the date at which dividends are to be treated as paid.

This is a fairly common issue.

Let's consider the technical position. A dividend can be authorised in one of two ways:

- It is declared and approved by the directors; this is an 'interim dividend' or
- It is declared or proposed by the directors and approved by the shareholders by written resolution or in a general meeting. This is a final dividend.

An interim dividend is treated as paid when the shareholder receives the money or when the funds are placed at the shareholder's disposal. This might include crediting an amount to a loan account. A final dividend is treated as paid on the date that it is declared as the voting of this creates an immediately enforceable debt. The exception is where the dividend resolution fixes a later date for payment, which is common in quoted companies, so the date of payment is then the later date.

For most OMB type businesses, the dividends paid are interim dividends and not final dividends. It is typically the case that we would be looking to identify the date of payment. In many cases, that payment will be by way of credit to the loan account, rather than physical payment.

Backdating of documents of any kind is fraudulent but probably what we are looking at here is likely crediting to a loan account retrospectively and this is something which is widely undertaken.

This does not fall neatly into any of the categories within the PCRT as many would argue it is not tax planning.

However, one of the criteria of the PCRT is that members must act lawfully. It could be argued that it is not lawful to treat a payment as made when it clearly has not been made. But it is acknowledged this is a difficult issue. As noted above, these cause more problems than the more complex planning where the route is much clearer.

A client is the 100% shareholder in his company and suggests bringing in his spouse as a shareholder as she has no other income.

Another fairly common issue.

In this case, there is no provision which stops a spouse being a shareholder in a company.

However, you would need to consider the application of the Settlements provisions to the scenario, and any advice on this point would need to be client specific and consider the uncertainties about the application of these provisions (which still exist even with cases like *Arctic Systems*).

A husband and wife who have a large property portfolio want to transfer that to a company in order to avoid the restriction on interest relief but avoiding a tax charge on such a transfer would depend on proving that it was a business and arguing that a partnership exists.

This is, in some ways, more interesting in terms of the way in which PCRT impacts on day-to-day tax planning.

There are two technical arguments here, both of which are a matter of fact. Is there a partnership and is there a business? In neither case is it a case of interpretation of the legislation – it is about reviewing the facts to come to a conclusion.

Any conclusion reached should include reference to counter arguments and alternative views which might be put forward by HMRC. The conclusion should, of course, be justifiable by reference to the facts and not swayed by the fact that the client wants a particular outcome.

A more interesting point is that the existence of a partnership is not really a tax law issue and it might be argued that most advisers would not have the technical competency to make a sustainable judgement on that point (although it may be pretty clear that no partnership exist which might be something you would not need to take further advice on!).

If you concluded that this could be done tax effectively you would probably want to make a full disclosure to protect clients.

You sign up a new client who tells you that he jointly owns his rental properties with his wife and that she is allocated 90% of the rental income from those properties as she has no other income. At the Land Registry the property is shown as being held solely by the client.

This is an area where there are significant compliance issues.

Many married owners of jointly-owned rented properties assume that so long as they declare the profit on one of their individual tax returns then that is their legal liability done. But this is not necessarily correct, particularly if there is an uneven split of income and the taxpayers may need to complete a Form 17. In this scenario, it is unclear that the property is even jointly-owned.

It might be that there has been a trust deed put in place which does transfer a beneficial ownership of the property to the spouse, but this would need to be evidenced by a copy of the deed. However, this is not sufficient on its own.

By default, tax law (s.836 ITA 2007) holds that rental profit from property jointly owned by spouses/civil partners is taxed 50:50, irrespective of the underlying respective proportion of actual ownership; this does not apply, however, to property held within a business partnership proper. Again, it is a misconception that all that has to be done is to submit a Form 17 to HMRC and the profit is taxed at a different split to the default 50:50.

If it would be more efficient for income tax purposes to split the profit differently, then the profit may be divided according to that beneficial ownership. Such unequal ownership is achieved only as tenants in common and it is then that a Form 17 is relevant. Form 17 must be signed jointly: if one spouse/civil partner does not sign then both must accept the standard 50:50 default split. The form is also only appropriate between two married/civil partners living together.

Once HMRC have been notified, the new proportions remain in force until the couple's beneficial interests in the property change or one spouse/civil partner dies, or they stop living together as a married couple/civil partners. The form must be submitted within 60 days of the date of the declaration and cannot be backdated, the time limit being strictly enforced with no power of extension.

So, you need a trust deed to show beneficial ownership and then a Form 17 to notify HMRC. If those are not available, an assumption needs to be made that the ownership of the property resides with the husband and that there have been incorrect returns submitted in the past. The client would have to rectify those returns or the adviser would have to reconsider whether they wanted to act for the client.

A client, who you have acted for over many years, tells you that they have moved into a property which you know has been let for two years to the same tenant. The property is sold shortly afterwards and the client tells you that the gain does not need to be declared as the gain will be covered by principle private residence relief. They tell you that they also lived in the property before it was let.

This is a case where the PCRT requires you to exercise some skepticism in your dealings with the client. This is clearly an area where there is scope for tax to be avoided if the contentions made by the client are incorrect.

It would be important to make sure that there is evidence that the client did qualify for private residence relief so that there was evidence both that the client did live at the property and that the occupation had the necessary degree of permanence and expectation of continuity for it to qualify for the relief.

In a case which went before the FTT in 2016 (*Mitesh Kothari v HMRC* TC04915) a wide range of factors were considered in determining that private residence relief was not available.

Evidence that the property had become K's permanent home was provided in the form of an electricity bill and a TV licence, issued to K and his wife at the Park Lane address and a Council Tax bill for the property, though sent to his previous address. K stated that his intention to reside in the property was changed after an agent told him in February 2009 that a good price would be possible; he put it on the market and an offer was made in March.

HMRC's position was supported by the short length of actual occupancy; the statement that K wished to be close to his office in Mayfair, even though the office was not rented until February 2009; the fact that the flat had only two bedrooms despite K's family including a wife and three young children; and K's inability to afford living in Park Lane Place, given his accumulated rental losses which would be lost. He had indicated in conversation that the move to Park Lane Place was provisional until it was clear that the family enjoyed living there; he had not moved any of his furniture, but simply bought the last tenant's furniture; and he had not changed the schooling arrangements for his eldest child.

It would be expected any adviser would be reviewing all of the information and acting accordingly if they felt their client was not being honest about the true facts.

A client ran a pub which ceased trading and since the cessation he has been trying to get planning permission on the building to enable it to be converted into flats. He has always intended to sell the site with planning permission rather than undertaking the development himself. You realise that you are approaching the point where it is 3 years since cessation so that it is unlikely that there will be a third-party sale within that period. The relevance is that he cannot claim BADR on a sale after 3 years, and his tax rate will be 20% rather than 10%. You suggest that he appropriates the property into trading stock, notifying HMRC that he has commenced a property development business, even though he is still intending to sell as soon as planning permission is obtained but this crystallises the capital gain.

The question is whether this is acceptable tax planning? The question of whether he has commenced a trade would be governed by considering the badges of trade but it is a matter of fact whether you are trading. You would be well advised to make a full analysis of the strength of any argument for and against trading.

Would it be a better option in some ways to actually transfer the property into a new company which was registered as trading? This would incur an SDLT cost and many would consider that protection against the risk of challenge from HMRC but that is a debatable point.

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