AAT tax update 12 November 2013

In this week's edition of the tax update we look at:

1. HMRC publishes guidance on apportioning the price on a transfer of a business

Valuations of property, goodwill and business assets can often be difficult. For many practitioners, it is an area of practice encountered relatively rarely and the **23 page practice note published by HMRC** is to be welcomed. It gives illustrative examples using pubs and residential care homes but the underlying principles for analysing a composite price into its different components will apply for many businesses which are transferred as a going concern.

HMRC have published an updated practice note running to 19 pages with a further 4 pages dealing with examples (pubs and residential care homes). It is essential to apportion the price paid for the transfer of a business as a going concern where the business involves a trade related property. The price paid must be apportioned between the various assets in order to establish the CGT position, to calculate SDLT payable by the purchaser and to calculate capital allowances and possible balancing charges. HMRC's note deals mainly with issues that have arisen where the property is a 'trade related property' valued using a profits approach, as HMRC recognise that there can be particular difficulties in identifying the sum attributable to 'goodwill', which is fundamental to the apportionment.

Getting this right could make the difference between paying tax on a balancing charge at 45% and getting a 10% rate on assets qualifying for entrepreneurs' relief.

2. Government announces plans to tackle avoidance schemes using transfer pricing rules

This 4 page note details the type of scheme which HMRC are trying to prevent and which takes advantage of the compensating adjustment rules in transfer pricing.

The Government announced on 17 September 2013 that it intended to legislate to restrict the use of the compensating adjustments mechanism in the transfer pricing legislation where it generates income tax advantages. Where a transfer pricing adjustment has been made to one party to an actual provision, the counterparty may use the mechanism to make a claim to adjust their taxable income by a compensating amount if the relevant criteria are met. The Government's intention is to counteract tax advantages that can arise where such adjustments are claimed by individuals for transactions entered into with connected companies.

HMRC have become aware of two main arrangements:

- Service companies that are under-remunerated by partnerships for the services that they provide.
- Interest receipts that arise to individuals from debt in highly leveraged companies and/or which has excessive rates of interest.

The technical note includes background on the transfer pricing rules and the compensating adjustment mechanism, examples of the arrangements being targeted and outlines the proposed changes. No compensating adjustments will be possible in respect of amounts of service fee income or interest arising to individuals on or after the 25th October 2013 which is the date that the legislation comes into effect.

Legislation will be included in Finance Bill 2014 and will take effect from 25 October 2013. Amendments from the initial proposals outlined above have been made in **a new 5 page technical note** such that, where interest is paid to individuals by highly leveraged companies:

- Interest which is disallowed in the company as 'excessive' will be treated as a distribution and taxable at dividend rates.

- To clarify that compensating adjustments will continue to be available for interest accrued but not yet paid up to and including 24 October 2013.

No changes have been made to the proposals relating to partnership service companies, which will apply to service fee income accruing on or after 25 October 2013.

3. Legal Costs of a partner were allowed for tax

In **Peter Vaines v The Commissioners of Revenue & Customs [2013] UKFTT 576,** Mr. Vaines claimed £215,455 as a tax deduction which related to a payment made in settlement to Bayerische Landesbank under an agreement made by a number of individuals who were connected with the law firm Haarmann Hemmelrath. Haarmann Hemmelrath had ceased to trade and owed approximately €17 million to Bayerische Landesbank and other banks. Until 31 December 2005 the Appellant had worked in the London office of the law firm Haarmann Hemmelrath which had many offices, in Germany and elsewhere.

At all material times Mr. Vaines was a partner in the law firm of Squire Sanders & Dempsey. In the year ended 5 April 2008, the year he claimed the deduction for the £215,455, Mr. Vaines was in professional practice as a partner in Squire Sanders & Dempsey and his share of profits from the firm represented his only source of professional income for the year. Mr. Vaines believed that the risk of challenging the German banks through the German courts was unacceptably high because if they were successful he would be made bankrupt. If he were made bankrupt, the Appellant would lose his position as a Partner in Squire Sanders & Dempsey.

The key to this decision is in Paragraph 3 when the First Tier Tribunal (FTT) found as a fact that his purpose for making that payment was to preserve and protect his professional career or trade.

HMRC were trying to disallow the payment on several grounds. HMRC argued that it was capital. They also argued that it was too remote from his professional activities as a solicitor in a London partnership because the litigation arose from his business in a different German legal practice. In addition HMRC argued that the expense was incurred to avoid personal bankruptcy and therefore not wholly and exclusively for the purposes of his profession.

This decision of the FTT is an interesting contrast to *Duckmanton v HMRC* [2013] UKUT which I reviewed in the AAT Tax Update 23 September 2013. Mr. Duckmanton had been denied a tax deduction for his considerable legal costs in defending himself against a gross negligence and manslaughter charge after one of his employees killed a pedestrian when driving a lorry.

Paragraph 29 states: “As Mr Vaines submits, in the present case no asset or enduring advantage was brought into existence by the payment he made to Bayerische Landesbank. Given our finding that this payment was to preserve and protect his professional career or trade it must follow that it is a revenue and not capital payment and for the reasons above is deductible being incurred wholly and exclusively for the purposes of his trade.”

The HMRC arguments failed and the FTT held that the sum paid by Mr. Vaines was allowable in computing his taxable profit. For tax purposes, any incidental benefit obtained by Mr. Vaines personally was to be ignored.

4. Public Accounts Committee (PAC) grills HMRC senior staff on HMRC performance

The rhetoric and ill-informed debate about tax avoidance and tax planning continues. Last Monday’s Dispatches featured Richard Murphy criticising Utility Companies for their structures while admitting that what the companies did was perfectly legal. Then, speaking at the CBI conference Mr. King, the head of J Sainsbury, was reported to say: “I disagree strongly with the argument of some that tax is not a moral issue. Actually it is a moral issue. How we put back into the community, back into the society from which we draw our revenues, is a moral issue –and it is one that our consumers have every right to ask of us.”

Tax in the UK is complex and our politicians have performed dreadfully over a very long period and many parliaments. It remains a disgrace that taxpayers wishing to self-assess are faced with the UK tax legislation. The cost of compliance is unacceptably high and yet, as we shall see in next week’s podcast, a taxpayer who incorrectly reports a gain instead of income could face penalties after relying on advice from professional advisers.

Tax Assurance Commissioner Edward Troup, Director General of Business Tax Jim Harra and Director General of Enforcement and Compliance Jennie Granger were grilled by Margaret Hodge and the PAC at the end of October. Given that politicians are responsible for the mess that is the UK tax legislation, they appear to have a bit of a cheek to blame the senior officials for the tax gap and the difficulties in collecting tax from the Swiss–UK tax agreement. It was revealed that the agreement will not yield the £3.12bn windfall expected this financial year.

Ed Troup was reminded, at 17:15 on the Monday evening that:
17:15: Hodge: "Is it true that you once said taxation is legalised extortion, Ed Troup?"

Troup: "In the context of that article [a past Financial Times article], those words appeared. It's late on a Monday afternoon, I admit, I did write those words, I believe Mr. Murphy has put most of it up on his blog today.

I fear that Mr. Troup will be haunted by those words. Reading Hansard is probably a good cure for insomnia but this was a better read than most.

5. **Agent Update 38 - October 2013 (PDF)**

The bi-monthly round up of the latest developments in tax, HMRC service and consultations for accountants and tax professionals and a section on the latest news and issues from the Working Together network has been published.

At 12 pages this must be essential reading for accountants. This month's top articles are:

Single Compliance Process briefing paper for tax agents
This note explains the outcome of the evaluation of the Single Compliance Process which has been tested by HMRC.

Alternative Dispute Resolution (ADR) for SMEs and individuals - A new way
After a two year trial and extensive consultation with professional bodies and the voluntary sector, ADR becomes part of normal HMRC business. HMRC has also published a summary report of the pilot for ADR for large and complex cases. See summary report of the pilot for ADR

Employee shareholder status
Employee shareholder is a new employment status, available from 1 September 2013. HMRC have published guidance on tax rules that apply to the employment shareholder shares received by individuals, in return for agreeing to the new employee shareholder status.

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12 November 2013

The views expressed in these podcasts are Derek Allen's personal views and do not necessarily represent AAT policy or strategy.