Association of Taxation Technicians

Examination

May 2005

PRINCIPLES OF LAW

Suggested Solutions

Question 1

1

The objects of the company are set out in the memorandum of association

The memorandum of association binds the company and members as if it were written into contract

A company can alter the objects in the memorandum of association by passing a special resolution or resolution in writing signed by all the members

The members are Ted, Bill and Ben

Ted will be unable to change the memorandum of association without the cooperation of Bill or Ben, as he does not hold 75% of the votes. Then all Bill and Ben need to do is vote against Ted's motion.

2

There is a general fiduciary duty upon a director not to make a secret profit

Strict rules govern a 'substantial' property transaction between directors and a company

These apply to any property worth over £100,000 or 10% of the company's assets

The contract is avoidable by the company if the members have not approved it beforehand

3

The members of a company have power to remove directors by passing an ordinary resolution

A member who wishes to propose a resolution must give notice to the company at least 28 days before the AGM ('special notice')

The company must then forward a copy of the notice to the director concerned who has the right to speak at the meeting and to circulate written reports to the members

An ordinary resolution requires a simple majority

Bill and Ben acting together do not have a majority and are unlikely to gain Ted's cooperation which means that they will be unable to remove the directors

Question 2

1. Duration of liability

New partners are liable for debts of the firm incurred after they become partners. (1) They are not liable for debts incurred before that unless they agree expressly or by implication to assume liability, or they have been held out as partners.
Retired partners continue to be liable for debts incurred before their retirement, unless creditors and their former partners agree to release them.
Three categories of creditor may have claims against a retired partner in respect of the firm's debts incurred after the retirement. They are:

(i) a creditor who had dealings with the firm before the partner's retirement and who has dealt with the firm thereafter. The retiring partner must give actual notice of his retirement to these creditors.

(ii) a creditor who begins to deal with the firm only after the partner's retirement, but who knew before that he was a partner. The retiring partner is required to give notice of his retirement to these creditors by advertising in the Gazette.

(iii) a creditor who begins to deal with the firm only after the partner's retirement and who only later becomes aware that he was a partner. No liability is incurred unless the retired partner permits himself to be held out as still being a partner after he has retired.

2. Limitation of liability
An unlimited liability partnership is not a separate legal entity.
The partners are personally liable for the debts of the firm and their liability for those debts is unlimited.
It is possible to establish an LLP under the Limited Liability Partnerships Act 2000, which allows limitation of liability of the partners. Such a partnership is treated as a body corporate and is a separate legal entity.

3. Partnership Agreement
Ideally the partnership agreement should cover the following matters:

(i) the firm's name, the place of business and the nature of the firm's business;
(ii) the date on which the partnership is to commence and its duration;
(iii) the proportions in which capital is to be provided and whether interest is to be paid on capital before profits are divided;
(iv) the way in which profits are to be shared and provisions for partners' drawings;
(v) meetings of the partners and the management of business;
(vi) restrictions on the activities of partners, for example other occupations and businesses in which the partners may not engage, particularly if they are competing or would expose a partner or the firm to risk;
(vii) the admission of new partners and the retirement or expulsion of partners;
(viii) the death or retirement of a partner; this usually takes the form of an option or an accruer clause;
(ix) the keeping of books of account, the preparation of an annual profit and loss account and balance sheet, and provisions dealing with taxation;
(x) an indemnity for each partner against liabilities incurred in the ordinary and proper course of business, or in the course of acting to preserve partnership property or business; and
(xi) dispute resolution: usually arbitration, mediation or through the courts.

4. Dissolution

Dissolution occurs:

(i) by effluxion of time, if the partnership is entered into for a fixed term;

(ii) by termination of the venture, if the partnership was entered into for a single venture;

(iii) by the death or bankruptcy of a partner or by notice given by a partner, unless the partnership agreement otherwise provides;

(iv) by subsequent illegality, that is, an event occurs which makes it unlawful to continue the business; or

by order of the court, for example, on permanent incapacity of a partner or on just and equitable grounds.

Question 3

Answer 3.1

Manor House is real property as all freehold land and buildings are classified as such.
The freehold interest in Garden House is also real property, but the lease in Garden House is a chose in possession.
The patent is a chose in action as all forms of intellectual property are classified as such.
The lease over the barn is also a chose in possession, a chattel real.
The tractor is a chose in possession, a personal chattel as it forms moveable plant and machinery.
The antiques and paintings are personal chattels, being choses in possession which are not chattels real.
The castle is real property.

Answer 3.2

Property may be owned jointly by 2 or more persons in 2 ways.
Joint tenancy means that the whole property is owned by 2 or more persons, each holding 100% of the property.
This is often how a husband and wife will hold property.
On the death of one joint tenant, the property passes automatically to the other. The property is said to pass by way of survivorship.
It does not pass under the deceased's will or on intestacy.
If co owners want to dispose of all or part of the property they must all agree to do so.

The other way of holding property jointly is as tenants in common.
Here each person holds a specific share in the property.
The co owners are said to hold in "undivided shares" that is each has an interest in the whole of the property but has a defined share of that property.
The individual owners are able to dispose of their share in the property to whoever they wish and there is no need for the other co owner to agree.
On the death of the co owner the share held by him will pass under his will or on intestacy and not by survivorship.

Answer 3.3

Fred has the legal and equitable ownership of the castle. However, once the castle is placed in trust for Bam Bam, the title changes and the legal title remains with Fred (he is still shown as the registered owner of the property) but the equitable interest will pass to Bam Bam. Legal and equitable interest in the castle has then been split between Fred and Bam Bam.

Answer 3.4

The rule which determines which law applies is the "lex situs".

Land is immovable property and has a fixed geographical site that determines its situs.
Therefore, as the castle is in Scotland, lex situs will determine that Scottish law will apply to the castle.
Security for the loan will have to comply with Scots law (as it relates to property which is subject to Scots law) but the loan agreement itself may state whether English or Scottish law should be applied to decide disputes under the loan agreement.

Question 3 – solution for Scots Law

3.1 Scotland has a four part division of property – heritable (corporeal and incorporeal) and moveable (corporeal and incorporeal).

Manor house – corporeal heritable property
Garden House – ditto
Barney's lease over Garden House – incorporeal heritable property
Patent – incorporeal moveable property
Fred's lease over the barn – as Barney
Tractor – corporeal moveable
Furniture etc – ditto
Castle – corporeal heritable property
Secured loan – the security is incorporeal heritable property, the debt itself is incorporeal moveable property

3.2 "Assuming Fred and Wilma own Manor House in common, explain the main features of this type of ownership."

- each person owns own share, which may be in equal or unequal proportions
- each person has complete power of alienation over own share – may gift it or bequeath it to someone other than the other co-owners
- the share gives right of use over the whole property, except by agreement of the parties
- each co-owner has the right to an action of division and sale, which means that the court will order the property to be divided, or where this is impracticable, for the property to be sold and the proceeds divided.

3.3 "Explain the main differences between ownership in common and joint ownership?"

- Joint ownership is a more restricted type of ownership than common ownership.
- No joint owner may alienate his share.
- On the joint owner ceasing to be owner, whether by lifetime event or on death, the joint share automatically accresces to the other joint owners.
- Examples are trust property, club property and joint liferents.

3.4. "Explain the legal formalities of creating a trust in which the truster is also a trustee. In the event that Fred places the castle in trust for his daughter with Fred as trustee, how would this change his legal interest in the castle?"

Where the truster is also the sole trustee, the trust must be created in writing (Requirement of Writing (Scotland) Act 1995 s 1(2)(a)(iii)).
Intimation should be made to the beneficiaries.
There is no requirement to convey the property to the trust.
In the event that the property is placed in trust, Fred remains legal owner of the property but qua trustee rather than as outright owner.
This means that he must exercise the rights of ownership in accordance with the terms of the trust, enforceable by a personal action against the trustee by the beneficiaries.
His creditors may no longer attach the property in the trust.

Answer 4

1

An offer may only be accepted whilst the offer is still open
An offer can be terminated by the refusal of the offeree
Where the offeree, instead of accepting the original offer makes a counter offer varying the terms proposed by the offeror, the original offer is impliedly rejected
The offeror may revoke (or withdraw) the offer at any time before acceptance
But the revocation is only effective once it has been communicated to the offeror
An offer may lapse if not accepted within the period stated by the offeror
However if a precise period of time has not been stipulated acceptance must be within a reasonable period of time. What is regarded as reasonable will depend on the case in question.
An offer may be expressly or impliedly subject to a condition precedent, and failure of this condition will terminate it automatically.
The death of the offeree or (in usual circumstances) the offeror will terminate the offer

2

A party is entitled to damages for breach of contract and may also be entitled to specific performance or specific implement in Scotland
The aim of damages is to put the injured party in the position it would have been in had the contract been properly performed
But an injured party is under a duty to mitigate his loss
i.e. he must take all reasonable steps to limit the damage caused and not stand idly by and allow the position to deteriorate further
Specific performance/specific implement is an equitable remedy where the Court may order the Defendant to carry out the terms of the contact
This remedy is at the discretion of the court and will only be awarded where it is just and equitable to do so

3

Contracts that are illegal by statute or common law are void
These would include contracts to defraud the Inland Revenue or HM Customs & Excise
Contracts that are contrary to public policy such as restraint of trade clauses may be void
The Courts will look to see if the restraint is reasonable
i.e. is the clause imposed to protect the legitimate interest of a party, is it a reasonable safeguard of that interest and is it reasonable in the interest of the public?

<u>Question 5</u>

Answer 5.1

Every contract of employment contains an implied term that the employee owes his employer a duty of fidelity and obedience that he will perform the work his employed to do with due care and diligence and will not use for personal benefit, or disclose to others, the employer's trade secrets or confidential information.

An employer has an implied duty to take care of an employee's safety and to uphold the relationship of trust and confidence between employer and employee.

If no express termination period is agreed between the parties, statutory notice generally applies, which is one week for each complete year of service up to a maximum of 12 weeks.

Under the common law there is an implied term that the contract may be terminated on the giving of reasonable notice. Reasonable notice could exceed the statutory notice and depends on a number of factors such as the seniority of the employee.

Answer 5.2

5.2.1 A claim for unfair dismissal may be made by an employee who has more than one year's continuous service who has been dismissed without a potentially fair reason or without following a fair and reasonable procedure.

If the dismissal is for a reason which is found to be unlawful discrimination, such as sex or race, the employee is not required to have any continuous service. Some reasons for dismissal are automatically unfair, for example pregnancy related dismissals or because of a transfer of a business under the TUPE Regulations 1981.

5.2.2 In order to bring a claim, an employee must have been dismissed. Dismissal may occur where an employer terminates a contract with or without notice; where a fixed term contract expires and is not renewed; or where an employee is constructively dismissed. Termination by mutual consent is not dismissal.

5.2.3 An employment tribunal can award reinstatement in the same job. It can order reengagement (in another suitable job with the same employer). It can also award compensation.

Reinstatement and reengagement are rarely awarded. In most cases the tribunal awards compensation, which is made up of 2 elements. The first is the basic award, which is calculated in the same way as statutory redundancy pay based on the employee's age, his weekly pay and length of service. There is a statutory cap on a week's pay of £260 and service is capped at 20 years.

The second element is the compensatory award, which is calculated on the basis of the employee's losses up to the date of the hearing and any future losses. This can include expenses of trying to find new employment. The award is subject to the duty to mitigate and is currently capped at £53,500.

If the dismissal was unfair for a discriminatory reason then the employee could also be awarded compensation for the discriminatory act and for injury to feelings. There is no cap on the compensation for unlawful discrimination.

Question 6

1. Tax evasion and tax avoidance

   Tax avoidance is the use of legitimate means to reduce the incidence of tax. A tax adviser may properly advise or assist their clients to reduce their liability to tax.

   However, the courts are wary of schemes or arrangements whose sole purpose is to avoid tax. In recent years, the courts have taken an increasingly firm stance in finding that such schemes do not achieve their purpose.

   Tax evasion is unlawful. A taxpayer who dishonestly withholds or falsifies information for tax evasion purposes may be subject to criminal proceedings or suffer civil penalties. A tax adviser who is a party to tax evasion is subject to the sanctions of the criminal law.

   Concealment of material facts may constitute tax evasion.

2. Elements of a crime

   Most criminal offences require two distinct elements, a guilty act, the actus reus, and a guilty mind, the mens rea.

   In the majority of cases, the prosecution must establish beyond reasonable doubt that a defendant committed the guilty act whilst having the appropriate guilty state of mind.

   There are however some offences where the law does not require any mens rea and these are known as offences of strict liability. In these cases the defendant is guilty of an offence if the act is committed. It is irrelevant whether there was any intention to commit a criminal offence or not.

3. Specific criminal offences

   (i) Theft – the definition of theft is "the dishonest appropriation of property belonging to another, with the intention of permanently depriving the other of it".
   (ii) Cheating the public revenue – the offence of cheating the public revenue is a common law offence and requires no positive act of deception. The offence is committed by fraudulent conduct which results in a loss to the Crown.
   (iii) False accounting – the offence of false accounting is committed where persons dishonestly, with a view to gain for themselves or another, or with the intent to cause loss to another, falsify documents made or required for accounting purposes or, in providing information, make use of documents which they know are false in a material particular.
   (iv) Fraud – for an offence of fraud to be committed, there must be some kind of deceit or intention to deceive. There must also be some injury or loss, which is either caused or intended as a result of that deceit.
   (v) Conspiracy – the offence of conspiracy is committed where two or more persons agree to carry out a course of conduct which will result in the commission of an offence or, which would do so, but for the existence of facts that would make the commission of the offence impossible.
   (vi) Conspiracy to defraud – it is an agreement between two or more parties dishonestly to deprive a person of something or to injure some proprietary right enjoyed by that person.

4. Prosecution policy of the Inland Revenue

   The Inland Revenue has indicated that the main categories of offence for which it considers criminal prosecutions are appropriate are:

   (i) where the case is so grave that public policy requires criminal prosecution, even if full disclosure is made. An example is where the offender is a tax adviser;
   (ii) where the taxpayer denies irregularities or fails to make a proper disclosure within a reasonable time;
   (iii) where the taxpayer purports to make full disclosure, but subsequent enquiry shows that the disclosure was materially incomplete; and
   (iv) where there is a second offence or series of offences following an earlier investigation.