



**Association of Taxation Technicians**

## **Examination**

May 2006

### **PRINCIPLES OF LAW**

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SUGGESTED SOLUTIONS

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## **Answer One**

A trust which is expressly created by deed or will is called an express private trust.

The first of these is a bare trust or nominee arrangement. The trustee holds the property on behalf of the beneficiary and must act in accordance with the beneficiary's instructions. The trustee is the legal owner but has no discretion as to how to act.

An example of a bare trust might arise in a company situation where the legal title to shares is held by A but he holds as bare trustee for B has the power to vote, but must do so in accordance with B's instructions and must pass any income from dividends received on the shares to B.

The second type of trust is a life interest or interest in possession trust. The beneficiary (the life tenant) is entitled to use the trust property during his lifetime. On his death, the property passes to another beneficiary (the remainderman).

An example of a life interest trust might arise in a family situation where husband might leave the family home to his wife for life remainder to the children. In this way the wife can remain living in the property during her lifetime, but has no control over the destination of the property on her death - it must pass to the children in accordance with the terms of the trust.

The third type of trust is a discretionary trust. This is the most flexible form of trust. No one is entitled to the income from the property. A discretionary trust is often used to benefit a group of people.

For example property may be put in trust by a father, for the benefit of such of his children as the trustee thinks fit. The trustees may then pay out as little or much of the income from the trust fund as they think fit and to whichever of the children they choose.

The fourth type of trust is an accumulation and maintenance trust. This is a trust which meets the conditions in IHTA 1984 s 71.

It is often set up by parents and grandparents and is favourably treated for IHT. The conditions are that one or more of the beneficiaries will become entitled to the income or capital by at least the age of 25, that until that happens no interest in possession exists, and that the income is either accumulated or distributed for the maintenance education or other benefit of one or more of the beneficiaries, and not more than 25 years have elapsed since the settlement was made, or all the beneficiaries have a common grandparent.

## Answer Two

Your address

hr manager address

Dear Mr X

Re      Employment status

I am writing to confirm the difference between employed and self employed status as requested.

It is not always easy to decide if a person is an employee of yours or if he is self employed. An employee would be someone who worked for you under a contract of service for example a shop assistant working fixed hours in a shop is likely to be an employee. An electrician for example who runs his own business and who came into the shop to rewire the electrics (under a contract of service) is more likely to be an independent contractor and self employed.

It is important to know the employment status of each of the consultants as the rights and obligations applying will depend on that status.

An employee will have protection against unfair dismissal, a self employed person may not. You will be vicariously liable for the acts of your employees whilst acting as your employees, you may not be liable for wrongful acts of a self employed person. Were the company to go into insolvency, the employees would be preferential creditors in relation to outstanding wages, any sums due to a self employed person would not be preferred in the insolvency. Employees are entitled to jobseeker allowance, statutory maternity pay, statutory redundancy pay, sick pay and other benefits, a self employed person is not. Employees' tax is deducted through the Pay As You Earn system. Tax owed by a self employed person is not. Many statutory health and safety provisions apply to employees but not to self employed contractors.

However both self employed and employed individuals have the right not to be discriminated against on grounds of sex, race or disability.

### How may status be determined?

The title given to the contract between the consultant and the company is not conclusive nor is whether the consultant works part time.

Generally the more control the company has over the consultant's work, the more likely the consultant will be an employee.

Other factors which indicate employed status rather than self employed status will include, who provides the equipment used by the consultants, the length of the engagement, the regularity of the hours worked, and how regularly the consultant is remunerated.

One issue to consider is whether the consultant is in business on his own account, does he carry his own insurance? If so, he is more likely to be self employed.

Consider also how integrated the consultant is in the business- is he part and parcel of the business or is he merely required on an occasional basis?

The courts consider also whether there is "mutuality of obligation"- in other words, does the consultant have an obligation to work, and does the company have an obligation to provide work for him to do? If so, he is more likely to be an employee.

Finally you should consider whether the consultant has an obligation to perform the services in person or whether he has the right to substitute a third party- if he does, then he is more likely to be self employed.

As you can see the issue is far from simple and I would be happy to advise on specific individual's circumstances should you wish me to do so.

yours sincerely

a candidate

### **Answer 3**

#### **1) Tax avoidance and tax evasion**

Solution should cover the following points (credit given for other relevant points):

- avoidance is lawful – the use of legitimate means to reduce taxation
- evasion is unlawful & involves dishonesty .i.e withholding or falsifying information to avoid tax
- concealment of facts may constitute tax evasion

#### **2) Crime and the burden of proof**

Solution should cover the following points (credit given for other relevant points):

- mens rea – criminal intent
- actus reus – the criminal act itself
- burden is beyond reasonable doubt that defendant committed the act with the appropriate intent
- for some crimes there is strict liability which means that only a guilty act is required whether or not the defendant intended it

#### **3) Professional privilege**

- relates to the confidentiality that professional advisors have in relation to papers, letters and other documents in their possession
- which arise as a result of their professional relationship with the client
- general rule: advisors under no duty to disclose privileged information unless required to do so by law
- unauthorised disclosure by an advisor is a serious breach of the duty of confidence owed to the client and may also amount to a breach of contract

#### **4) Disclosure without client authority**

There are a number of Acts of Parliament that allow enforcement agencies to demand information including the TMA which empowers HMRC to demand certain documents

- s.20 TMA 1970 gives HMRC power to call for documents which may contain evidence about a tax liability.
- Sub-section (3) applies to third-parties such as tax advisors
- The legislation does not override LPP (1)

Which means that HMRC cannot call for documents covered by LPP (1), but S.20C(4A) TMA defines LPP as covering communications between client and advisor made in connection with the giving of legal advice and therefore only covers lawyers and not accountants or other tax advisors.

More limited protection is available to other tax advisors under s. 20B(9) which protects 'relevant correspondence'. This is defined to include communications the purpose of which is to give tax advice.

This protection only covers the advisor, not the client.

Additionally, a tax advisor must produce documents if ordered by the court by way of a court order or subpoena or may be required by the General or Special Commissioners to produce documents.

#### **Answer 4**

##### **1) Contracts binding on partners**

- PA 1890 sets out the authority for partners to make contracts
- A partner acting in the course of business will bind the others on a joint and several basis but will not be binding if:
  - he did not have the authority to act AND
  - the person with whom the partner was dealing knew he did not have authority
- As the building firm knew of the disagreement it is unlikely that the contract will be binding upon Ash and Bobby
- However the order for the books appears to be a normal part of the business and there was no disagreement hence that contract will be binding

##### **2) Liability of partner joining partnership**

- Eric would be liable for the debts incurred after he joins as partner
- Eric would not be liable to debts incurred before UNLESS:
  - he expressly agreed otherwise; or
  - he held himself out to be a partner beforehand

##### **3) Liability of partner leaving partnership**

- Ash would be liable for debts incurred before his retirement
- Some creditors may have claims against Ash after his retirement if he
  - still holds himself out as a partner; or
  - fails to give actual notice of retirement to existing creditors (such as removing name from letterheads)
- for creditors who deal with a partner after retirement but knew before he was a partner then full protection is gained only by putting an advert in the Gazette

#### **4) Duties owed by partners to each other**

- Partners owe a duty of good faith to each other
- Must render true accounts and full information on all matters affecting the partnership
- Must account for any profit made using the firm's property, name or trade connections
- A partner can carry on business on his own account, unless he agrees otherwise, but he must account for any profit made in that business if it is of the same kind or if it competes with the firm

#### **Answer 5**

##### **1) Separate legal entity**

###### *Liability of members*

In theory members should have no liability for the debts of the company, because the company is an entity distinct from its members. In practice, however, the extent of a member's liability depends on the type of company concerned. The company itself is liable for its own debts.

###### *Perpetual succession*

Each member has an individual relationship with the company but not with the other members (unlike a partnership). A member may be given the right to transfer his shares to others (a right which may be restricted). Despite changes in membership the company continues in existence as a separate entity until it is terminated in the prescribed legal manner (for example by winding-up proceedings).

###### *Ownership of property*

A company owns its own property. Hence, a shareholder cannot appropriate the company's property for himself, a point often not appreciated by shareholder-directors who control their own companies.

###### *Contractual capacity*

As a separate legal entity a company can enter into contracts by which it is bound.

###### *Litigation*

A company can sue and be sued in its own name. If a wrong is done to the company, it is the company which must take legal action.

###### *Management*

Because a company is an artificial legal person, it must act through individuals. Unlike a partnership, where each partner has ostensible authority to bind the firm, a shareholder in a company has, as such, no authority to bind the company. Management is delegated to directors, who generally speaking have such authority. CA 1985 requires private companies to have at least one director, and public companies at least two. The directors generally have responsibility for the day-to-day running of the company

### *Maintenance of capital*

The share capital, which is created when members subscribe for their shares, is a fund which the company must preserve for its creditors in exchange for the advantages of limited liability and incorporation. Special rules therefore restrict, for example, the payment of dividends out of any funds of the company except available profits.

### *Taxation*

A company is taxed separately from its members.

## **2) Lifting the corporate veil**

The fact that a company is a legal entity separate from its members, directors and managers produces unsatisfactory results in certain circumstances. Company law, therefore, recognises a number of exceptions to the principle. In those circumstances the company is to some degree identified with its members or directors, ignoring the distinction between them. In these cases it is said that the corporate veil is lifted.

This usually results in some other person sharing liability for the company's debts, or in the attribution of the assets, liabilities, profits and losses of the company to its shareholders.

For example, if the business of a company has been carried on with an intent to defraud, a court may declare that the directors or others who were knowingly parties to the fraud are liable for some or all the debts and other liabilities of the company. Directors are also personally liable if they are found guilty of wrongful trading, that is of continuing to trade when they know that the company cannot meet its debts.

An individual who is subject to restrictions cannot use a company to evade those restrictions. For example, an employee who is subject to a valid restraint of trade clause cannot set up a company in an attempt to circumvent its provisions, on the basis that the company is a separate legal person and not party to the contract between himself and the former employer. The court would uphold the restraint of trade clause against the former employee and the company he had set up

## **3)(a) Company limited by shares**

The liability of a member of a company limited by shares is limited to the amount, if any, unpaid on the member's shares. Once the shares are fully paid there is in general (subject to instances of lifting the corporate veil) no further liability. Hence, if the company becomes insolvent the members are not required to make any further contribution to discharge its debts. Companies of this type are the most common for business operations

Limited liability is often considered to be one of the key benefits of incorporation. It is invariably the case, however, that major creditors of a private limited company insist on taking personal guarantees from the company's directors or shareholders. In particular, the bank and landlord of the company's premises may refuse to deal with the company unless such guarantees are given. This significantly reduces the advantages of limited liability status.

## **(b) Companies limited by guarantee**

The liability of members of a company limited by guarantee is limited to the amount that they undertake to contribute in the event of winding up. If a company is wound up, each member at the time of winding up or within one year of winding up may be required to contribute up to the amount of his guarantee towards the payment of debts incurred while he was a member. The amounts involved are normally quite small.

Many charities are formed as companies of this kind, as are many trade or research associations. The associations aim to recover the cost of their services by charges or levies on users. As companies limited by guarantee, they have the advantage of corporate status, and members' guarantees are a form of reserve fund which can be called on in times of crisis or urgent need.

## **Answer 6**

### **1) Legal, equitable and overriding interests**

Legal interests – These are limited but include easements (e.g. rights of way) and charges by way of legal mortgage. Legal interests bind the purchaser even if he has no notice of them.

Equitable interests – Any other interest will be an equitable interest. Which must be protected by registration – in which case it binds every purchaser. Examples – restrictive covenants, beneficial interests under a trust, contracts (there are various types of contracts e.g. sales, options and pre-emption rights).

Overriding interests – The owners of some interests of land are protected even if those interests are not protected on the register, they bind the purchaser whether or not he has notice of them. The two most important ones are; the rights of persons in actual occupation and leases granted for less than 21 years.

### **2) Planning, environmental and other matters affecting enjoyment of land**

Some matters which affect people's use and enjoyment of land have come about through Parliament's intervention. The Town and Country Planning Acts (simply called Planning Acts in Northern Ireland) forbid many types of development on, and changes of use of, land unless the local planning authority consents. Public bodies may be able to use compulsory purchase orders to force people to sell land. (Under similar provisions in Northern Ireland vesting orders can be made.) The land may also have various environmental liabilities attached to it.

A buyer is bound by such matters in any event but can find out about many of them by searching registers held by the local authority (a "local search") , the environment agency (which also covers risks of flooding) and other, sometimes commercial, bodies. Buyers who are worried about environmental risk often hire consultants to do environmental surveys. The extent of the survey depends on the assessment of the likely risk: discredited dyeing or munitions factories tend to alert even the most carefree of buyers.

### **3) Land registration**

The Land Registry keeps a register of all registered land in the country, which shows who the current owner is and what interests affect the land such as mortgages, restrictive covenants etc. The aim of the register is to provide the buyer with notice of all other interests on the land and to



allow the seller to prove his title to the land. Many third party interests, including mortgages and restrictive covenants, will only affect the buyer if the owner has taken the trouble to enter those interests on the register.

#### **4) Identifying interests over land**

The prospective buyer can identify whether there are any interests over a particular piece of land by either examining the title deeds (in the case of unregistered land) or the register of titles at HM Land Registry where the purchaser will search the register for interest on the land. Most third party interests must be registered in order to affect a buyer. However, the owners of some interests in land are protected even if not entered on the register and so the buyer has to also inspect the land and make full enquiries of the seller to ensure that there are no such interests in a particular case.

#### **Answer 6 – Scots Law**

(i) Main impact is that the feudal system is finally abolished. This means the feudal superior can no longer require the payment of feu duty, neither can he, qua superior, enforce any real burdens (restrictions upon use) in the title of those who own the property.

(ii) The general nature of a real right is that it is enforceable against the world rather than against a particular person. It is often described as a right in a "thing" as opposed to a right against a person. The most common example of a real right is the right of ownership of property, whether corporeal or incorporeal or moveable or heritable, thus one can defend oneself as owner of property against any person seeking to infringe the rights of ownership.

If a person (A) contracts to sell property to another (B), until B has actually become owner, his only rights are against A for delivery of a disposition (the deed which will enable him to become owner) and to prevent A from granting any other deed which may give someone else the possibility of defeating B from becoming owner. It is not until B registers the deed granted by A in the Land Register that B becomes owner and can defend his rights in the property against the world. If, before B registers his deed, A fraudulently grants a second deed in favour of C, and C registers his deed first, C becomes owner and B's remedies are only personal remedies against A.

Examples of real rights apart from ownership are lease, proper liferent and the rights mentioned in (iii) below.

Examples of personal rights are contractual rights, rights in delict, rights of a beneficiary against the trustees of a trust in which the beneficiary has an interest.

(iii) The real right of ownership in land is normally the right to have possession and enjoyment of the land, although the right of occupation can be in the hands of another. It includes the right of sale, gift and bequest of the property. It is acquired by the registration of title in the Land Register.

A servitude right is the right of one owner of property, usually adjacent or at least close by, to use another's property. The right of access is the most common. The right is not personal but rests in the owner for the time being of the property and when the property is sold, the right transmits automatically to the next owner of the property.

A real burden is a restriction on the right of ownership which can be enforced by other owners of property in favour of which the real burden was granted. A typical real burden would be a restriction on the use of property, for example restricting its use for residential purposes only. Real burdens may now only be created in a deed which is in the Land Register.

A standard security is commonly called a mortgage, which is strictly English terminology. The security is granted by the owner of property to a security holder, commonly a bank or building society, in security for a debt. In the event that the borrower fails to make payments in accordance with the contract of loan, the security might be "called up". This means that ultimately the lender takes possession of the property with a view to selling it, taking what is due by the borrower, and returning any excess to the owner. It is a real right in the sense that even if the borrower no longer owns the property, the property may still be sold by the lender for the purposes of recovering his debt.