THE CHARTERED INSTITUTE OF TAXATION

The Chartered Tax Adviser Examination

November 2008

PAPER III

INTERACTION OF TAXES

Suggested Answers (without marks)

Where candidates are required to comment on tax (and in particular CGT) which may apply in 2008/09 and subsequent years they will be given full credit whether they assume that 2007/08 rates (including taper relief) continue to apply or whether they answer using 2008/09 rates (including entrepreneurs relief).

Question 1

Report for Mrs Mary Harrell (MH)

Taxation Implications of Disposal of Assets, Cessation of Trade and Relocation Overseas

Introduction

This report has been prepared to cover the issues arising from the proposed cessation of your trade and the disposal of various assets. It considers the tax implications of the proposed relocation abroad.

Facts

(Per question – assumed will be reproduced in firm's standard format)

Summary of issues

You have various intentions which can be summarised as follows:

- Disposal of your private residence
- Cessation of the participation in your current trading business. The options are
  - Transfer trade to son
  - Cessation of trade
- If the trade ceases you can either sell the lease or surrender it to the landlord
- You may consider living abroad but it is unclear whether this will be permanent

Each of these issues will be considered below.

Availability of relief on sale of private residence

If you sell your private residence you are potentially eligible for Principal Private Residence Relief (PPRR). This is an exemption from capital gains tax where an individual sells a property which has been his only or main residence at some time during the period of ownership. If the property has not been used as his only or main residence throughout the period of ownership then part of the gain may be chargeable to tax. Relief is also available on the disposal of land which is used as the garden or grounds of the property up to the permitted area (being ½ hectare) or such amount which exceeds the permitted area which is needed for the reasonable enjoyment of the property. It is important that any land sold is part of the garden.

Because you have not lived in this house throughout the period of ownership then the gain will need to be apportioned in order to establish the amount exempt under the PPRR rules. This is considered below. The garden associated with the property is less than ½ hectare so there is no restriction in relation to the gain arising on the sale of the land. The field next door to the property is likely to be considered as not part of the garden as it is separated from the garden and does not appear to be used as garden or grounds. As such, it would not be eligible for PPRR. However, it would be recommended that the property be visited to assess the possibility of arguing that it is part of the garden.

Where the property has not been the main residence throughout the period of ownership, the gain is pro-rated over the period of ownership between the time when it has been the main residence and the time it has not. For the purposes of calculating this apportionment the period of ownership cannot go back further than 31 March 1982.

However, certain periods of absence can be treated as if they were periods of occupation. The most common one is the final three years of ownership, although in this case that is not relevant because you are actually living in the property currently. However, other periods of absence which can be treated as periods of occupation as follows:

- Any period of three years absence for any reason
- Any period throughout which the individual was absent from the UK due to employment
- Any period of up to four years when an individual is prevented from residing in the property in consequence of the situation of the place of work

Extra Statutory Concession D3 states that, in the case of a married couple living together, if the condition is met by one spouse, it is deemed to be met by the other spouse.

For any of these periods of absence to be counted, the individual must occupy the property as his residence both before and after the period of absence. For these purposes, although the period of ownership is not deemed to commence until after 31 March 1982, any periods of occupation prior to that date would enable this condition to be met. There are also particular rules for individuals living in job-related accommodation. If someone is living in job related accommodation and has a property which is intended to become his private residence once he is no longer in job related accommodation, then that property is treated as being his main residence for PPRR purposes even though he is not living in it.

For you, there are periods of absence, and you do fulfil the condition that you lived in the property both before and after the absences. The first period of absence does not qualify specifically but you will be eligible for deemed occupation due to three years of absence for any reason. The second period of absence would appear to qualify since you were absent due to your husband's employment overseas. .

On this basis the rules apply to you as follows:

April 1982 – April 1987 (61 months):	Unoccupied but 36 months would be treated as authorised absence
May1987 – September 1992 (65 months):	Occupied as main residence
October1992 – May 2000 (92 months):	Unoccupied but treated as occupied due to reason for absence
June2000 – April 2009 (107 months):	Occupied as main residence

Total period of ownership since April 1982 = 325 months (or 27 years and 1 month)

Actual period of occupation:	172 months
Deemed period of occupation:	36 + 92 = 128 months
Total	300 months

This means that 300/325 of the gain arising on the property will be subject to PPRR.

Another relief, called "lettings relief", is also available to you because the property has been let out as residential accommodation. This lettings relief is calculated as the lower of the following three amounts:

- The amount of PPRR which is due on the property
- The gain which is attributable to the period when let which has not already received PPRR as deemed occupation
- A fixed amount of £40,000

The period when let which has not already received PPRR is simply the period from 1 April 1982 to 30 April 1987 less 36 months of deemed occupation. Thus the gain when let eligible for the lettings exemption is 61-36 = 25/325.

On the basis of the assumptions currently applying to this gain, the computation would then be as follows:

	£	£
Potential proceeds		750,000
Less estimated allowable costs		(10,000)
Less March 1982 value		(35,900)
Gross gain		704,100
PPRR (300/325 x gain)		(649,938)
Lettings relief		
Lower of:		
De minimis	40,000	
PPRR	649,938	
Gain when let = 25/325 x gain	54,162	
		(40,000)
Net gain		14,162
Less annual exemption		(9,600)
Chargeable gain		4,562
Tax @ 18%		821

If the property is sold on or before 5 April 2009, this tax would be due on 31 January 2011. If the sale were delayed until after 6 April 2009, the tax would be due on 31 January 2012.

Rent a room relief

You have been letting out a room in the house and this income has not been put on your previous tax returns. This income, however, is likely to fall within the rent a room scheme which exempts from income tax gross furnished letting income not exceeding £4,250 in a tax year. This applies only if the accommodation is not self-contained, is part of the main residence and is for residential use only. If the gross income exceeds this, then the excess will be subject to tax (although the profit could be computed on normal principles where expenses are deducted from income and the balance taxed if this is more beneficial).

As the lodger has been paying £70 per week the total income will fall within the limit of £4,250. As long as these conditions apply, then there are no undisclosed tax liabilities for earlier years that need to be considered. If the gross receipts are below the exemption limit, then rent a room is treated as applying unless the taxpayer elects to disapply the treatment.

Where the gross receipts are in excess of the exemption limit, then the taxpayer must elect for the rent a room provisions to apply. In this case, the gross receipts are less than the limit so there is no further action needed.

There are no specific provisions in relation to the interaction of rent a room relief and private residence relief. Provided the lodger shares all of the facilities of the home with the owner (and this is likely if the accommodation is not self-contained) then there will be no restriction on the PPRR available on the eventual sale by the owner.

Sale of adjacent field

On the basis of the information held, the gain on the land next door to the main property will not be covered by PPRR as the land does not form part of the garden.

As the proposal is to grant an option, there are special rules applying to the tax treatment.

The grant of the option is a chargeable event for CGT purposes. The option is treated as an asset separate from the underlying land, so there is no allocation of any costs to the grant of the option. Therefore, you will be subject to CGT on a gain of £30,000 in the tax year in which the option is granted.

If the option is never exercised, this will remain and no further issues arise.

However, if the option is exercised, the two transactions are effectively merged; in effect the price paid for the option is treated as part of the proceeds for the sale of the land itself. The CGT liability in the tax year in which the option was granted is removed and the option money added to the final sale proceeds. The date at which the composite transaction is deemed to take place for CGT purposes is the date of the actual sale. So the tax on the £30,000 would be reduced to nil and a gain based on proceeds of £500,000 would become chargeable in the year in which the sale occured with all the allowable costs associated with the land being deducted in that computation.

Computation

	£
Option proceeds	30,000
No costs	
Chargeable gain	30,000
(Assuming the annual exemption will be used in sale of house)	

If option is exercised:

Proceeds	500,000
Less March 1982 value	(4,500)
Gross gain	495,500
Less annual exemption	(9,600)
Chargeable gain	485,900
Tax @ 18%	87,462

If any private residence relief is due on the field (see comments above) then there may be some difficulty in actually claiming the relief. This is due to the fact that the sale of garden or grounds can only qualify for relief from CGT if it is sold at the same time or before the sale of the house which itself qualifies. [Varty v Lines 1976]

Business cessation

There are three options for you to consider in relation to the cessation of your business:

- Transfer of business to your son
- Cessation of business with surrender of lease to landlord
- Cessation of business with sale of lease to third party

Cessation of the business

The only assets on the balance sheet of any value are the stock and the lease. These will have to be dealt with on cessation. Any cash that remains can simply be retained without any tax consequences. Due to the nature of the business, it is likely that there is no goodwill in the business. On the basis that no goodwill has been acquired by you at any time in relation to this business, there will be no loss arising on the cessation.

Any items of stock you keep personally on cessation will have to be treated for tax purposes as if they have been sold at market value (see below for comments on stock on cessation). It is assumed that all other items will be sold to other dealers prior to cessation and will be included as sales in the final period of account.

For the lease, there are two possibilities: that the lease is surrendered to the landlord; or that the lease is sold to a third party. Both of these would be a disposal of the lease for tax purposes.

The computation of the tax position of the lease has to be done in various stages as the capital acquisition cost which would normally be set off against any proceeds has to be restricted:

- the premium paid has to be reduced by any amounts on which income tax relief has been claimed;
- the remaining premium has to be reduced to reflect the fact that it is a wasting asset.

The lease was taken out on 1 April 2005 and it is assumed it will be sold or surrendered at 31 March 2009. This is a period of four years and the deduction claimed over this period would be £2,400 x 4 = £9,600. So the basic premium treated as capital expenditure is reduced by this amount to £40,400. It is this figure which is then reduced.

The formula for calculating the amount to be excluded from allowable expenditure is (P(1) – P(3)) / P(1) x the expenditure which would otherwise be allowable under s38(1)(a) TCGA 1992.

P(1) is the percentage derived from the table in Para.1 Sch.8 for the duration of the lease at the beginning of the period of ownership and P(3) is the percentage from the same table for the duration of the lease at the end of the period of ownership.

P(1) (which is the figure for 15 years) is 61.617 and P(3) (which is the figure for 11 years) is 50.038.

The amount to be excluded from allowable expenditure is therefore:

$$\frac{61.617 - 50.038}{61.617} \text{ x } 40{,}400 = 7{,}592$$

The allowable expenditure is therefore £32,808.

If the lease is surrendered for no consideration to the landlord, then this amount will be a capital loss for you which would be available to set off against any capital gains arising in the same year or in the future. If the surrender means that you are relieved from any financial obligations such as the need to make good any dilapidations, then the value attributable to the release will be treated as consideration. This would effectively simply reduce the amount of the loss.

If the lease were sold, the allowable expenditure as calculated above would be deducted from the proceeds to give the gain arising (or loss accruing) on the disposal. If the sale price were £15,000 then the computation would be as follows:

	£
Proceeds	15,000
Wasted cost	(32,808)
Net loss	(£17,808)

Again, this capital loss could be set off against any gains arising in the same, or subsequent, tax years. For example, if the disposal of the lease took place in the same year as the grant of the option on the land, or the sale of the private residence, then this loss could be used to reduce the gains on either of those two events.

Transfer of business to son

If the business is transferred to your son this will involve the disposal of any capital assets and a transfer of the stock to him. The only other asset of the business is cash.

The only capital asset of any value is likely to be the lease as it would appear unlikely that a significant value (if any) could be put on goodwill. It is assumed for the purpose of this report that goodwill does not have any value.

Any disposal would be deemed to take place at market value as this is a connected party transaction. Although any gain could be covered by a holdover relief claim under s.165 TCGA 1992, the computation above shows that there is a net loss based on a market value transaction. A holdover claim would therefore not be necessary. You could crystallise the capital loss and use it as discussed above.

It is necessary to consider the value at which the stock would be transferred to your son if he took over the business. Where a business ceases there are basically four options as to how the stock is valued. These are as follows:

- Stock is sold to an unconnected trader. In this case, assuming that the purchaser can claim a deduction for the cost of stock in calculating the profits of a UK trade, then the sale price is the value realised by the sale.
- Stock is sold to a connected trader. In this case, assuming that the purchaser can claim a deduction for the cost of stock in calculating the profits of a UK trade, the stock must be valued at the amount that it would have realised had the transaction been between independent persons dealing at arm's length.
- Stock is sold to a connected trader and an election is made in which case the value is: the greater of its acquisition value; and the price paid by the purchaser.
- In all other cases, the open market value of the stock is used.

If your son takes over the business, the sale would be treated as taking place as if it were between independent persons dealing at arm's length unless an election is made between you to transfer as indicated above. The election has to be made within two years of the end of the chargeable period in which the business ceases.

Any transfer of assets at less than market value would be a transfer of value for inheritance tax purposes. It would be a potentially exempt transfer which would have to be taken into account if you were to die within 7 years of the gift although the transfer may be covered by business property relief

Income tax implications

When a business ceases, the basis period for computing the profits for the year in which the trade ceases begins on the day after the end of the basis period for the previous tax year and ends on the date of cessation. It is possible to deduct overlap relief from the profits arising in the final period. However, you commenced on 1 April 2001 and have always used a 31 March year end so no overlap profits will have arisen.

If you ceased on or before 31 March 2009, the year of cessation would be 2008/09 and the profits for that year would be those arising from 1 April 2008 to the date of cessation, whenever that is. If the cessation takes place after 31 March 2009, the profits for the period from 1 April 2008 to 31 March 2009 will form the basis of assessment for 2008/09. The cessation will fall in 2009/10 and the profits for the period from 1 April 2009 to cessation will be assessed for that year. It may be worth reviewing the potential profits over the final period to see when would be the most tax efficient point to cease the business.

You would need to notify NICO that you are no longer required to pay Class 2 NICs as you will no longer be self-employed.

Implication of emigration to Spain

An individual is only liable to capital gains tax on disposals made in a tax year when they are resident or ordinarily resident within the UK. If you were to leave the UK before the end of the current tax year and then sell your capital assets in the following tax year, initially no capital gains tax would be payable. If this route were adopted, you would clearly have to consider the tax implications in the jurisdiction in which you were to become resident.

For the purposes of capital gains tax legislation it is the date of exchange of contracts that is relevant for determining the date of disposal. So you would need to be sure that any contracts for the disposal of your assets were not signed until after the end of the tax year in which you left the UK.

However, there is anti-avoidance legislation where an individual disposes of an asset whilst non-resident but returns to the UK shortly afterwards. This is found at s.10A TCGA 1992. If someone leaves the UK, disposes of assets and then returns to the UK and there are less than five full years of non-residence between the year of departure and the year of return, then any gains made whilst non-resident will be subject to UK capital gains tax in the year of return. The exception to this is in relation to assets purchased whilst non-resident. The final condition is that the individual had been resident or ordinarily resident in the seven years immediately preceding the year of departure.

If you were to leave the country before 6 April 2009 and then sell your assets after that date, those gains would not be subject to UK capital gains tax assuming you did not become resident again before 6 April 2014. This is a risk if you are not sure whether you wish to remain permanently outside the UK. However, the gain would not come back into charge until the year in which you became resident again.

There are also income tax implications of the emigration to Spain. Both pension income and investment income arising in the UK will remain taxable in the UK even if the recipient is resident and ordinarily resident in another jurisdiction. However, unless the income arises from property within the UK or is investment income connected to a trade in the UK, the tax charge for non-residents is restricted to the amount of tax, if any, which is deducted at source.

The specific rules are that the tax paid on all income cannot be more than:

- The amount of tax that would be chargeable on income, other than disregarded income but before deduction of any personal allowances plus
- The amount of tax deducted at source from the disregarded income.

Disregarded income includes interest from banks and building societies, dividends from UK companies, income from unit trusts or National savings and pension income.

Thus if you elect for your interest income to be paid gross once you are non-resident and not ordinarily resident, there will be no tax payable on this income at all. To do this, you need to make a not ordinarily resident declaration on form R105.

The only complication which might arise is if any of the cash generated by the transactions discussed above were invested into property as this would not be disregarded income. Where your UK tax liability is limited via the income disregard rules, personal allowances are not available to you. Therefore if the amount of income which is not disregarded is high, it may be more tax efficient for you to claim the personal allowance and include your entire UK income in your tax computation.

Question 2

Solution 1

CHRIS & ELEN STORNAY

NOTES TO TAX MANAGER ON CHARGEABLE ASSETS

Inheritance tax chargeable assets

Both Chris and Elen will be deemed domiciled in this country for the purposes of inheritance tax such that all of their worldwide assets will potentially be chargeable

Each current asset will now be considered separately in this connection for ease of reference

Main residence with flat and annexe

This will be fully chargeable within the estate to inheritance tax unless there is a prior gift without reservation.

Any liability on land and property may however be paid over ten years by annual instalments

A sharing arrangement with any of the children residing at home could be considered

For capital gains tax purposes it is necessary to examine the flat and annexe to see if these are within the curtilage of the main home and to examine any actual periods of usage or occupation to maximise the exemption on any sale

Land on annual grass let

The land would appear to be used for agricultural purposes such that the agricultural value should be exempt from inheritance tax

This could be through usage by Chris over the previous 2 years, or by use of others for 7 years for Elen

Chris may also obtain business property relief on any excess hope or development value present

So long as this is a defensible form of agreement and activities include such matters as fencing and fertilising then the income may be treated as earned income but it appears the trade is carried on solely by Chris and this would be better as a joint activity with Elen to maximise capital gains tax charges and roll over relief

This would also split the income to gain a national insurance benefit by reducing the liability

Development land

This land would also be fully liable to inheritance tax and there is no income shown as arising suggesting no activities are present on the land to gain any exemption

Land used for horses and dogs

This is fully chargeable to inheritance tax as usage for horses can never fall within the definition of agriculture or farming as such

It is possible Chris could have activities amounting to a trade so as to get business property relief and once again Elen should join Chris in the activities

A pure rental with no associated activities would not create any reliefs against this value in the estates however

Caravan storage barn

This is a pure investment asset and fully chargeable

All income is shown as belonging to Chris but this is incorrect and the income would rather be assessed on them equally unless they have elected for such alternative treatment in respect of their jointly owned asset

UK stocks and shares

Unless in unquoted trading companies or a controlling holding then the full value would appear to be assessable with no reliefs

On any sale perhaps the proceeds could be invested in qualifying companies to gain business property relief after a 2 year ownership period

UK bank accounts

Fully liable but perhaps could be used for gifts or investment in qualifying unquoted trading companies as above

South African bank accounts

Chargeable in the estate of Elen only in the event of her death or other chargeable transfer without retiring abroad and losing the deemed UK domicile

Planning considerations to mitigate future tax liabilities

The land and property is shown as owned jointly but it should be confirmed if this is as joint tenants or as tenants in common because of the differing treatments on succession

Even after they leave the country following retirement any UK situs assets will remain within the charge to inheritance tax for a further three years so they may consider removing assets such as the bank accounts or investments to an offshore account

Following the cessation of residence the investments could be sold free of capital gains tax in this country so long as they remain non resident for a five year period

Whilst deemed domiciled in this country it would be sensible for Chris and Elen to reduce their chargeable estates if they can do so without adversely affecting their standard of living

They are relatively young and it is not wise to give away too much too soon in this type of situation

If they do wish to make gifts then they should utilise the small gifts exemption but they are already using the annual exemptions in full

Indeed they are making gifts in excess of the annual exemption but the normal and habitual gifts out of income exemption should cover the excess

They could also use the marriage gift exemption if the opportunity arose in future with the children

As far as capital gains tax is concerned, the former trade (from ten years ago) will not create any charge on a deemed disposal at the point of emigration

Had a trade still been carried on as a non-resident then the assets used would remain liable to charge in this country but as there has been a prior cessation, the charge will not apply

There may however be a charge on the future disposal of the land under grazing agreement if that activity amounts to a trade (albeit carried on by a manager after leaving) such that a contemporaneous cessation of trade on emigration would be better to avoid this charge

Solution 2

Domicile Discussion

(These are the core areas to be discussed but candidates may also obtain bonus marks by extending into other relevant matters)

I consider Elen has retained her domicile of origin in South Africa for the purposes of income tax and capital gains tax for the reasons set out below:

(1) Elen takes regular holidays in South Africa where there remain family connections. There is a firm intention to return to that country following retirement providing the previous insecurities and instability has then improved such that there is a definite intention and time for the return.

(2) In order to lose a domicile of origin there must be regard to the balance of probabilities and this must be clearly and unequivocally proven. In this case Elen has not wholly rejected South Africa and this was considered in the *Gaines-Cooper* case.

(3) Similarly in *Surveyor* it was shown to be important to demonstrate an abandonment of the domicile of origin and under *Re Clore* there has to be continuing evidence of a settled intention to reside in another place for the rest of the days which is not the situation here

(4) Under *Bullock* it was also found the requisite intention to change domicile is not present if an individual would return to the country of origin on the happening of some certain and definite contingency so long as that contingency is not too remote or doubtful. In this case there is a definite intention to return following retirement subject only to suitable security and stability which is not at all remote or uncertain and I am of the opinion the South African domicile is still held.

(5) She was married after 1 January 1974 which means that she would not merely take her husband's domicile but is rather able to justify her own domicile independently of him

However, she will be deemed domiciled in the UK for the purposes of inheritance tax because she has been resident here for in excess of 17 out of the previous 20 years of assessment. As such all of her worldwide assets will be liable for charge under that tax and this situation will remain for at least three years after leaving this country prior to which the deemed domicile will remain

The minimal level of offshore income that remains unremitted will mean that Elen is however exempt from the £30,000 annual tax charge on non-domiciled individuals in order to remain on the remittance basis whereas she would have been fully liable to income tax in this country under the arising basis had she held a UK domicile

Solution 3

Letter concerning transfer of Land

Tax Adviser
Exam Centre
Near You
HI2 TAX

Chris and Elen Stornay
Old Farm Building
Dorset
DO3 5ET

Dear Chris and Elen

I note your proposal to transfer the development land for the benefit of the children and now write to outline the various taxation implications arising.

I note the land has been valued currently at £1 million and it is owned by both of you in equal shares.

There is no income apparently being generated from this land but I shall appreciate your confirmation of any usage and this is mainly to verify whether there may be any reservation of benefit difficulties following a transfer at undervalue. For example, if the land is used by you for exercising the horses then it will be necessary for you to pay a commercial rental for any continued use or there is otherwise a danger the gift will be ineffective for the purposes of inheritance tax.

We initially need to discuss three main areas of taxation being stamp duty land tax, capital gains tax and inheritance tax and I will comment briefly on these.

For the purposes of stamp duty land tax it is irrelevant whether the transfer is to the children outright or rather through a trust vehicle and in simple terms there will only be a liability if there is consideration passing. As such if the land is gifted there should be no charge under this heading.

Capital gains tax will also be an issue no matter what form of transfer is contemplated. Because the transfer is to a connected person you will be deemed to have sold the land at full market value and a capital gain will arise which will be taxable on you at 18% on any excess gain over the annual exempt amount. Because the land is not used in any trade then hold over relief will not be available on a transfer to the children direct. However if the transfer is to a trust where the beneficiaries are not minor children of yours then such hold over relief may be claimed to defer the charge on any notional gains.

The treatment for inheritance tax will vary considerably depending upon the form of transfer. If an outright gift to the children then the gifted value will be treated as a potentially exempt transfer and if you survive the gift by at least seven years with no reservation then the gift will no longer comprise your taxable estates. There is no need to file any form of return in respect of such a gift but the land will then belong absolutely to the children which may not be acceptable to you in view of their young ages and situations with regard to long term relationships.

The previous gifts would not be taken into account with such a direct transfer except in the event of a prior death but this again assumes there is no reservation of benefit nor any pre-owned asset charge in place as we have already discussed at the time of those earlier gifts.

If the transfer is to a trust vehicle then you may both be trustees so as to exercise some control over the land itself and you would also hold full discretion over the advancement of both income and capital.

Furthermore you can have a large class of beneficiary to include not only the existing children and the grandchild but to also include future born children and partners or spouses.

Indeed by each of you having a separate trust you could also include the survivor of you as a possible beneficiary without causing any reservation and this may be useful in the event of a premature death situation.

A gift into trust would be a chargeable transfer for the purposes of inheritance tax and this may give a small problem.

Although the previous cash gifts may be ignored because they are potentially exempt rather than chargeable transfers you are annually gifting in excess of the annual exemption but I will rely on the normal gifts out of income exemption to cover any excess such that the full nil rate band of £312,000 should be available to each of you.

This means that a gift of the whole land would create a lifetime tax charge at 20% on any excess value over and above that level. Although the present value has been set at £1 million that is also just an estimate and the actual value when negotiated with the district valuer could be considerably higher.

The disposal would have to be reported on your annual tax returns and you would also have to submit an inheritance tax return in respect of such a gift.

There are various methods of removing the lifetime charge to inheritance tax. For example you could gift part of the land now up to the value of the nil rate band and then make additional transfers after the seven year survival period if the land is still held. Alternatively you could transfer all of the land but some of it could be sold with a loan being left outstanding but care would then be necessary to avoid the actual consideration by loan creating a charge to stamp duty. Under this scenario, the loan could be repaid once the land is sold on and you could then make additional gifts as potentially exempt transfers to the children if you so desire.

Income of the trust from the land would be taxable at 40% although there is a reduced rate when taxing dividends if that situation arose. Such income may be accumulated for up to 21 years unless the trust deed provides for a lesser period.

Capital gains would be taxable at the same rate of 18% as would be the case if you sold personally but by using a trust you have effectively removed value from your estates to enable further planning. The value would not transfer to the estates of the children or other beneficiaries unless you granted a right to the income so their estates would not be unduly taxed in the event of their early death.

Even if you did die within seven years of the gift the value would be frozen at the value when gifted so long as there was no reservation of benefit over the gifted asset.

With a trust during the perpetuity period commonly of up to 80 years you can decide if capital is to be transferred out to any of the beneficiaries and if an asset is transferred to such a discretionary beneficiary it is possible to elect to hold over and once again defer any charge to capital gains tax.

Perhaps one disadvantage of a trust is the ten year anniversary charge whereby at each such occasion the trustees will incur a charge to inheritance tax at a maximum of 6% of the excess value over the then nil rate band. However when looking at a nil rate band trust at commencement it is possible to transfer out of trust immediately prior to the first such anniversary with no inheritance tax cost.

I have attempted to set out above general but relevant comments which will hopefully be of use to you in deciding upon the future transfer. If any further clarification on any point would assist then do please let me know.

Yours sincerely

Question 3

Suggested Answer

Report prepared by Alpha & Beta for the Finance Director of Bablyon Ltd

This report is organised in two parts; part I sets out tax considerations for the year to 30 November 2008 and part II indicates steps that may be taken by the group to mitigate UK taxation, interest and penalties.

Part I: UK Tax consequences for the worldwide group

Based on the information provided by the finance director of Babylon Ltd the following UK tax considerations will apply to the group.

Corporation tax considerations

UK resident corporations are subject to tax filing requirements under Corporation Tax Self Assessment ('CTSA') and the number of associate companies in a group will impact the calculation of marginal corporation tax bands. The acquisition of Rhodes Ltd by Babylon Ltd and the disposal of Chaeops Ltd by Artemis Inc should be reflected in an assessment of Babylon Ltd's associated companies for the period to 30 November 2008. From the information provided the Artemis Inc group would appear to have a number of wholly owned subsidiaries and we would recommend a review of the number of active associated companies in the worldwide group to ensure that any small company/marginal relief issues are correctly dealt with.

Cessation of trade

Rhodes Ltd has (albeit temporarily) ceased trade and notification of re-commencement of trade will be required to HMRC. There may be loss restrictions in Rhodes Ltd associated with a temporary cessation of trade (see below).

Losses

Under the provisions of s.393 trading losses incurred by a company in an accounting period (and not set off as group relief or carried back to a previous accounting period) can only be set against profits arising from the same trade.

Accordingly losses brought forward in Rhodes Ltd can only be set of against DI income from the same trade. Rhodes Ltd ceased to trade in March 2008 and recommenced trading activity post acquisition. The company now appears to be using a different business model using the Artemis Inc intellectual property/brand name. Accordingly there must be some doubt whether the same trade is being undertaken by Rhodes Ltd following the acquisition by Babylon Ltd.

In any event the application of s.768, ICTA 1988 will almost certainly impact any assessment of whether trading losses brought forward in Rhodes Ltd will be available to set against future trading profits.

It seems likely that the change in ownership of Rhodes Ltd has been accompanied by a major change in the nature and conduct of trade (as detailed above). The provisions of s.768(1)(b) may also be relevant in relation to the temporary cessation of trade. As a consequence the availability of these losses should not be relied upon when the UK resident companies quantify any payment due under the CTSA quarterly payments regime.

It is recommended that the whole issue of "change" of Rhodes Ltd is reviewed in some detail. A fact pattern should be established showing the events leading up to the closure and the re-opening of activities. A comparison should also be made of the nature of the business carried on pre and post acquisition.

Note that whilst this information has not been provided, subsidiaries may have non-coterminous year ends and the date of acquisition and disposal will determine the potential availability of loss relief.

Loan relationships

Under the UK corporate debt regime it is necessary for companies to bring into account for tax purposes the profits and losses arising from loan relationships calculated in accordance with accounting policies that reflect generally accepted accounting principles applicable in the UK. Trading loan relationships are treated as trading profits and losses whilst non trading relationships will be treated as DIII debits and credits.

Capital gains group Before 1 April 2000 the capital gains definition of a group of companies generally applied to UK resident companies only. FA2000 Sch 29 Para 1 removed the residence restriction, so that with effect from 1 April 2000, a company can be a member of a group regardless of where it is resident. Accordingly Artemis Inc is considered the principal company of the CGT group.

A company, referred to as the `principal company of the group', and all its 75 per cent subsidiaries form a group, together with any 75 per cent subsidiaries of those subsidiaries, and so on. This 75 per cent subsidiary requirement is in terms of beneficial ownership of ordinary share capital. But in addition a subsidiary can only be a group member if it is also an `effective 51 per cent subsidiary' of the principal company. This means that the principal company must have a beneficial entitlement (either direct or indirect) to more than 50 per cent of the subsidiary's profits and assets.

The 75 per cent subsidiary requirement in terms of ordinary share capital operates on a `cascade basis', that is, it has to be satisfied in relation to each tier considered separately. The effective 51 per cent subsidiary requirement in terms of profits and assets operates `top to bottom'.

A company can be a member of one group only. There are special rules for determining group membership where a company would otherwise be a member of two or more groups.

A group remains the same group so long as the same company remains the principal company of the group. If at any time the principal company of a group becomes a member of another group, for example on a company takeover, the first group and the other group are regarded as the same group.

Assets can generally be moved around a group without a capital gains charge. This is the result of the no gain/no loss rule in TCGA 1992 s.171(1). The rule states that if one member of a group disposes of an asset to another member of the group, and the asset remains within the scope of corporation tax on chargeable gains, the consideration is such an amount as secures a no gain/no loss result for the transferor. The no gain/no loss rule recognises that business activities carried on within the overall economic ownership of a corporate group, and within the UK tax net, should not suffer tax charges which would otherwise arise from the division of the group's commercial activities between different legal persons.

The no gain/no loss rule fixes both the consideration received for the asset by the transferor and the consideration given for the asset by the transferee. The transferor has neither chargeable gain nor allowable loss. The transferee effectively takes over the transferor's capital gains cost, as augmented by indexation up to the time of the transfer under TCGA 1992 s.56(2).

Section 171 transfers made in the six years prior to disposal of Chaeops Ltd may be subject to a section 179 de-grouping charge as Chaeops Ltd is leaving the capital gains group.

The first main condition for the degrouping charge, in TCGA 1992 s.178(1) and TCGA92 s.179(1), is that a company, `the chargeable company', acquires an asset from another company in the same group, and the chargeable company leaves the group within the following six years. The second main condition, in TCGA 1992 s.178(3) and TCGA 1992 s.179(3), is that when the chargeable company leaves the group:

- either the chargeable company, or an `associated company' (as specially defined), leaving the group at the same time,
- owns (otherwise than as trading stock)
- the asset, or another asset against which a gain on the first asset has been rolled over.

If these conditions are met the result is a deemed disposal by the chargeable company as at the time immediately following the intra-group transfer, so reinstating the tax charge deferred on that transfer by the no gain/no loss rule.

The event which triggers a degrouping charge is a company ceasing to be a member of a group. But the amount of the gain (or loss) is determined by reference to a deemed disposal immediately following the acquisition of the asset from another group member, and this may have taken place up to six years previously. Under TCGA 1992 s.179, the gain accrues in the normal way at the time of the deemed disposal, and forms part of the profits for the accounting period in which the deemed disposal falls. The rules extend the normal time limit for assessments so that an assessment on a gain resulting from a deemed disposal can be made up to six years after the degrouping event which triggers the tax charge.

Whilst any s.179 charges apply to the company leaving the group this liability is usually imposed on the vendor under the sale and purchase agreement. If it has not already been done a review of s.171 transfers involving Chaeops Ltd during the six years prior to disposal should be undertaken. We should also investigate the terms of the purchase agreement for Rhodes Ltd and verify whether it received any intra-group assets in the six years prior to its acquisition.

It should be noted that the disposal of shares in Chaeops Ltd would not give rise to a UK chargeable gain or loss as Artemis Inc is US tax resident.

Transfer pricing and thin cap

Under Sch 28AA, ICTA 1988, intra-group provisions that give rise to a UK tax advantage need to be priced at arm's length; the definition of an intra-group provision stems from the concept of participation in the management, capital or control.

Thin capitalisation will be relevant for funding structures and this impacts intra-group borrowing capacity and the terms of the funding (for example the rate of interest). The 'independent lender' test will be applied by HMRC and this looks at funding that would be provided to the borrowing company on a stand alone basis. Tax bulletin 17 (1995) outlined non-statutory safe harbours for borrowing capacity to include 1:1 for debt:equity; however, HMRC has moved away from these ratios in recent years in favour of the relevant economic circumstances impacting an independent lender.

In addition to pricing at arm's length, Schedule 28AA, ICTA 1988 also sets out documentation requirements to demonstrate that pricing is at arm's length. It should be noted that the CTSA returns of the group must either confirm that arm's length prices have been charged or appropriate tax adjustments to the corporation tax liability must be shown.

From the information provided it would appear likely that HMRC will seek to limit the amount of corporation tax relief, under the corporate debt regime, granted in respect of interest payments/accruals in respect of the funding loan from Artemis Inc.

The directors should also be made aware of the rules regarding the deduction of interest accrued but not paid for in respect of this loan and also the requirement to deduct income tax from interest payments on this loan (on the assumption that HMRC will not grant approval for the interest to be paid gross – unlikely in the current circumstances of thin cap and excessive interest).

In order to claim tax relief in full on the interest charged on the loan from Artemis Inc the directors of Babylon Ltd would need to convince HMRC that an independent lender would be prepared to lend funds on similar terms. Any evidence available to support this contention should be accumulated.

HMRC will also require that an arm's length charge is made in respect of the use by UK resident members of the group of intangible assets owned by Artemis Inc.

Corporate residence

Corporations are subject to UK corporate taxation where they are resident in the UK and tax residence is in the first instance identified by the jurisdiction of incorporation. Babylon Ltd is UK incorporated and this would point to the company being tax resident in the UK. However, central management and control will also be relevant in identifying where a corporation is resident. It is noted that the majority of the directors of Babylon Ltd are personally resident in the US and the fact that board meetings are held in the US may create a risk. These factors could indicate that in fact Babylon Ltd could be held to be dually resident in the UK and the US. A tax treaty tie-breaker may apply – however this issue is outside the scope of the syllabus. Bablylon Ltd does not appear to be an investment company and accordingly the group relief and group asset provisions regarding dual resident investment companies probably do not apply.

Information regarding the usual location of board meetings should be assembled together with details of where the day to day management of the UK companies is undertaken.

Anti-avoidance

The offer of one-off tax planning solutions may constitute tax avoidance; UK tax legislation does not apply a general anti-avoidance rule; however, there are case law precedents that render certain practices unacceptable (Furniss v Dawson etc). In addition, HMRC requires certain tax avoidance schemes to be disclosed

The disclosure regime was introduced with effect from 1 August 2004 and was limited in scope to tax arrangements concerning employment or certain financial products. This was widened with effect from 1 August 2006 to the whole of income tax, corporation tax and capital gains tax.

A tax arrangement must be disclosed when:

- it will, or might be expected to, enable any person to obtain a tax advantage
- that tax advantage is, or might be expected to be, the main benefit or one of the main benefits of the arrangement, and
- it is a tax arrangement that falls within any description ('hallmarks') prescribed in the relevant regulations.

In most situations where a disclosure is required it must be made by the scheme "promoter" within 5 days of it being made available. However, the scheme user may need to make the disclosure where:

- the promoter is based outside the UK
- the promoter is a lawyer and legal privilege applies, or
- there is no promoter.

The hallmarks are:

- Wishing to keep the arrangements confidential from a competitor.
- Wishing to keep the arrangements confidential from HMRC.
- Arrangements for which a premium fee could reasonably be obtained.
- Arrangements that include off market terms.
- Arrangements that are standardised tax products.
- Arrangements that are loss schemes, and
- Arrangements that are certain leasing arrangements.

Upon disclosure, HMRC issues the promoter with an 8-digit scheme reference number for the disclosed scheme. By law the promoter must provide this number to each client that uses the scheme, the taxpayer must include the number on his return or form AAG4.

VAT

Babylon Ltd and Rhodes Ltd can elect to form a VAT group for UK tax purposes and Rhodes Ltd will need to re-register for VAT on commencement of trading unless de minimis limits apply.

Whether Babylon Ltd and Rhodes Ltd chose to form a VAT group will probably be dependent upon the partial exemption position of the two companies and an assessment of any advantages/disadvantages which might arise from a group registration.

A review of the partial exemption position of the UK subsidiaries, including the treatment of inter-company charges should be undertaken.

Stamp Duty

Stamp duty will have been charged at 0.5% on the acquisition of shares in Rhodes Ltd. Assets may be transferred between group members without a stamp duty or SDLT charge arising (the definition of a group for these purposes is the same as a loss relief group) however there are anti-avoidance rules which may apply where assets are to leave the control of the group.

Other tax issues

Payroll tax and national insurance considerations should be considered in relation to the remuneration of directors and employees particularly non-resident/non domicile directors of Babylon Ltd.

Part II – Steps that can be considered by Rhodes Ltd to mitigate taxation, interest and penalties

Rhodes Ltd can consider the following areas that may mitigate taxation, interest and penalties:

Improved tax compliance procedures

Interest and penalties will be due on underpaid tax and late filing penalties also exist; it is important to assess why filings have not been on a timely basis and rectify this going forward. This will ensure that tax adjustments, interest and penalties are minimised.

Degrouping charge assessment

As discussed above, a s.179 de-grouping charge may occur following the disposal of Chaeops and a history of transfers should be reviewed to assess and mitigate tax risk. It is important to identify and account for these charges as soon as possible to mitigate tax risks.

IP centralisation

The use of the Artemis Inc brand name will be accompanied by the payment of royalties to the brand owner in the US. The choice of structure for this royalty payment will have a bearing on withholding taxation and source taxation in the jurisdiction of location of ownership. Effective planning may assist in minimising tax leakage associated with these intra-group royalties and may also provide opportunities.

Thin capitalisation planning

The tax bulletin 17 ratios referred to above are non-statutory and income cover ratios are also relevant (and arguably more important to independent lenders than debt:equity). With effective analysis of forecast cash flows, guarantees, market value of assets, and other economic considerations, a more aggressive tax filing position could be adopted within an acceptable arm's length range.

Loss planning

Utilisation of losses brought forward in Rhodes Ltd may be possible and cases including Kirk & Randall V Dunn (1924) will be important in assessing whether losses can continue through a period of temporary cessation of trade.

Directors remuneration

Some of the UK directors may be non-UK domiciled and these tax payers will generally be taxable on the remittance basis. Planning opportunities may exist to mitigate overall taxation payable for these individuals

Question 4

Briefing Report for the Tax Partner

Report for:	Ian Black - Tax Partner
Prepared by:	Chris Brown - Tax Manager
Subject:	East Newtown Garages Ltd (ENG) – Various tax issues
Date:	5 November 2008

Thank you for forwarding me the letter from Paul Orange of Zeta Holdings and the e-mails from employees of the group. I have prepared a technical report to assist you with your response to the client as requested.

I will refer first to the letter dated 30 October 2008 from Zeta Holdings.

1 Insurance Policies

(a) Insurance Premium Tax (IPT)

I have prepared some brief notes for Paul Orange about IPT and its relevance to motor dealers.

Insurance premium tax was introduced in 1994, initially at a single rate of 2.5%. It is a single-stage tax on premiums received under taxable insurance contracts. A taxable insurance contract is any insurance contract other than one specifically exempted, whether or not the insurance is offered by a company authorised to carry on insurance business. Exempt risks are specifically defined, and include, for example, long-term cover such as life insurance.

Unless exemption applies, the tax is charged at a lower rate of tax of 5%, and at a higher rate of 17.5% in appropriate circumstances. Risks located outside the UK are not liable to IPT in the UK.

The higher rate was introduced in 1997 as an anti-avoidance measure to prevent the practice of value shifting. This was carried out by retailers who sold insurance as part of a package of goods or services; typically it was an issue for car dealers as well as vendors of domestic appliances and travel insurance. I will explain this in further detail as follows:

Suppose a motor dealer has an associated insurance agent. Insurance is promoted as an optional add-on with every vehicle sold, and customers are encouraged to take out policies with the dealer's associated company. The majority of the agent's business is made up of such sales. This motor insurance arranged by the insurance agent would be regarded as 'connected' to the sale of the motor vehicle by the associated dealer and would be liable to IPT at the higher rate of 17.5%.

Alternatively, suppose the motor dealer has an associated insurance agent, but this agent operates completely independently and from a different site. No attempt is made by the motor dealer to promote the insurance arranged by this agent, and the car dealer's customers buy their insurance from a range of outlets. The motor insurance arranged by the insurance agent is not liable to the higher rates of IPT even if, coincidentally, it should occasionally be sold to customers of the associated motor dealer.

(b) Tax Planning

Paul Orange has asked about planning structures that could mitigate tax in this area. He is clearly aware of some recent case law developments, including some that have not been successful.

WHA Ltd

A claims handling company known as WHA Ltd put in place an arrangement to recover the input tax incurred on repairs and replacement parts under motor breakdown insurance policies sold by a UK insurance company. The scheme was very complicated, and involved the routing of supplies through two offshore companies in Gibraltar. Whilst WHA had initial success in the Court of Appeal, the case was revisited to consider the abuse of law principle under *Halifax*. The adjourned hearing found in favour of HM Revenue & Customs on the abuse issue. Consequently I would not recommend a planning structure along similar lines to Zeta Holdings Ltd.

Ford

In the case Ford Motor Company Ltd, Ford offered motor insurance purported to be 'free' to customers in conjunction with car sales. Ford considered that the insurance did have a separate price, exempt from VAT, which was a separate supply from the sale of the car. Accordingly, they claimed that output tax should not be paid on the consideration relating to the insurance.

The Court of Appeal dismissed Ford's claims that the insurance was a separate supply. Using *Card Protection Plan* principles, it judged that the insurance was a means of better enjoying the car rather than an aim in itself. Further, none of the consideration had been allocated to the supply of insurance, so no amount could be treated as exempt even if the supplies were separate. Accordingly, I would not recommend a planning structure set up in this manner to our client either.

Dixons

There has been a recent tribunal decision, IPT 0013, concerning IPT found in favour of DSG International Insurance Services Ltd. The issue concerned a retail company (Dixons) selling domestic appliances with extended warranties and repair contracts. These were insured through a group company established in the Isle of Man.

Contracts of reinsurance and contracts relating only to risks situated outside the United Kingdom are not taxable insurance contracts. The structure was intended to move the insurance risk offshore, thus removing the need to charge IPT.

The revised structure was implemented following the introduction of legislation in 1997 to charge IPT at the higher rate of 17.5% on sales of consumer goods with warranties. An alternative possibility identified was to offer customers non-insured repair contracts instead. A repair contract (sometimes called a service contract) is an agreement for the repair or replacement of mechanical goods in the event of breakdown after the expiry of the manufacturer's warranty. However, a repair contract is not a contract of insurance and so the sums due under it are not premiums and IPT is not chargeable on them. It was appreciated that repair contracts would be subject to VAT at 17.5% but there would be an entitlement to recover input tax, which would not arise under the original structure whereby IPT was charged instead.

To protect Dixons from the risk involved from the repair contracts, it was decided that the offshore insurance company would insure all the risk under the repair contracts.

HM Revenue & Customs argued that IPT was payable rather than VAT because the insurance contract remained taxable in the UK. They argued that the Isle of Man company was established in the United Kingdom because of the actions of its UK agent company.

According to HM Revenue & Customs, it was necessary to identify the place where the activity which created the risk was exercised. It was the repair contracts which gave rise to the risk and the relevant activity was the entering into the repair contracts. That was done by the UK agent company and so the contract of insurance related to a company established in the UK.

The Tribunal applied the ECJ decision in *Kvaerner plc* (C-191/99) on the interpretation of the Second Non-life Insurance Directive (88/357/EEC) that the establishment to which an insurance policy relates depends on "the place where the activity whose risk is covered by the policy is exercised". It held that this activity was located in the Isle of Man. The insured risk was "that of paying the cost of repairs on the breakdown of electrical products sold by Dixons" and that this was the obligation of the Isle of Man company only (and not that of the UK agent company). The location of the insurance obligations was therefore its establishment in the Isle of Man.

The insurance contract therefore related only to a risk which was situated outside the UK and was outside the scope of IPT.

Although this is only a decision of the tribunal, in principle a successful VAT/IPT mitigation arrangement may be possible using a structure involving the offshore insurance company within the Zeta Holdings group. Note, however, that abuse of law was not argued by HM Revenue & Customs in this case, and could feature in any future litigation. Thus this should be a caveat for any advice we give to the client.

Disclosure of Avoidance Schemes

Should Zeta Holdings decide to engage in a planning scheme which gives rise to a tax advantage when compared to adopting a different course of action, it will be required to notify HM Revenue & Customs about these arrangements if the scheme falls within categories defined by the law, or which contain features which are described as "hallmarks" in the law". This is in accordance with anti-avoidance legislation introduced in 2004. Failure to notify within the prescribed time limit would leave our client liable to a penalty of 15% of any tax saved.

We should offer further advice on this matter if required, and be prepared to assist with making a disclosure, if necessary.

2 Various VAT Issues

(a) Pool Car

You forwarded me an e-mail from Percy White, Head of Finance, at ENG. He enquired about the possible private use of a pool car by Bert Green in the service department at East Newtown Garages. Full VAT recovery was obtained on the purchase of the car.

The problem here concerns the possible input tax restriction on the purchase of motor cars. Since the introduction of VAT there has been an input tax block on cars, which acts as a proxy for the taxation of private use. Essentially, rather than requiring the trader to account for output tax on private use, the law requires a restriction of input tax.

Ordinarily, for cars purchased by a motor dealer as part of the stock in trade, VAT recovery is permitted. Further, cars used exclusively for business purposes and not made available for private use will also give rise to VAT recovery.

The controls ENG has in place for the pool car appear, on initial inspection, to satisfy the requirements specified at paragraph 3.7 of VAT Notice 700/64, namely that the pool car is:

- normally kept at the principal place of business;
- not allocated to an individual; and
- not kept at an employee's home.

However, the legislation, at paragraph 7(2G) of the VAT (Input Tax) Order 1992, requires that for the business use test to be satisfied, the taxpayer must not intend it to be made available for private use. HM Revenue & Customs are interested in the question of whether a car has the potential for private use rather than if such use is likely. This is a significant test that is applied strictly.

One of the leading cases in this area is *Upton (trading as Fagomatic Ltd).* The trader purchased a Lamborghini which he used in his business of refilling cigarette machines at London night clubs. The car was not garaged at his home, and he was able to convince the Tribunal that he never used the car for private purposes, and therefore he was justified in deducting input tax on purchase. However, the High Court judgment, confirmed at the Court of Appeal, was that the taxpayer had not taken sufficient steps to prevent the possibility of private use. A mere intention not to make use of the car for private purposes was not enough.

The case of *C & E Commrs v Elm Milk Ltd* reached a different outcome. In this case, the director of a 'one man band' company claimed input tax on the purchase of a car which he used solely for company business. The car was garaged 50 yards from the director's home and was insured both for business and private use. HM Revenue & Customs argued that there were no physical or legal restrictions preventing the car from being used for private use. However, prior to purchase, the company had minuted a board resolution stating that the car was to be bought with the intention that it be used for business purposes only by the director. Further it would be a breach of the director's terms of employment to use it for private purposes. The tribunal was satisfied that the taxpayer had placed a legal embargo on the private use of the car and the appeal was allowed. The Court of Appeal upheld the tribunal's decision as one of fact which it was entitled to reach on the evidence before it.

It is important that we establish the precise circumstances existing at ENG. If indeed Bert Green actually has private use of the car, even if only incidental, then the VAT recovery will be challenged. It will either have to be repaid, or a self supply charge made from the time that Bert Green first obtained private use.

If no private use is being made, the position could still be challenged by HM Revenue & Customs. It may be necessary to insert conditions into contracts of employment prohibiting private use of pool cars, with any such use, if identified, leading to a breach of contract and disciplinary action. Additionally, there should be a procedure in place for controlling keys, such that the car physically has to remain on the garage premises each night.

If it is deemed that Bert Green is able to have private use of the pool car, then there will almost certainly be PAYE implications. It could be argued that Bert Green receives the benefit in kind of a company car, taxed in a fiscal year as the relevant percentage, based on the CO2 emissions figure, of the list price of the model concerned. In the absence of a return of form P11D for Bert Green, the company will probably be liable for the grossed up amount of the benefit. The company may also be liable for penalties for failing to submit forms P11D and P11D(b).

Credit will be given for discussion of other relevant cases in this area

Other cases include Bhailok Fielding (2007), Robbins (2004), Shaw (2006)

(b) Part Exchange transactions

Percy White's e-mail discussed a procedure which is known in the trade as 'bumping'. It is a common practice to inflate the value of the part exchange car in order that the customer qualifies for the minimum deposit required by the finance company. However, in order for this procedure to work effectively, the price portrayed to the finance company has to be ignored when raising the tax invoice to the customer.

In the case of *North Anderson Cars Ltd v CCE* [1999] STC 902, it was confirmed that the correct sales price of the car, in accordance with Article 11A(1)(a) of the EC Sixth Directive, is

everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies including subsidies directly linked to the price of such supplies.

Thus it is necessary to account for VAT on the inflated price of the car, as shown on the HP agreement, rather than the showroom price.

The effect is that ENG pays over additional output tax to HM Revenue & Customs at 7/47ths of the inflated price. The following table shows a sample calculation:

	Original price (£)	*VAT thereon @7/47*	*Price after 'bumping'*	*VAT thereon @7/47*
Showroom price	9,400	1,400	10,000	1,489
Value of part exchange (deposit)	2,000		2,600	
Finance sought	7,400		7,400	

Percy White's e-mail also included a second issue about part exchanges. This concerned the sale of a used car which was acquired from a private individual as a part exchange transaction. Here, no VAT was incurred on the purchase of the used car because the individual is not VAT registered. Thus, when the used car is resold, the car dealer has the option of accounting for VAT as a fraction of the full sale proceeds, or using the second hand margin scheme.

The dealer is able to recover the VAT incurred on the parts and the valeting. These are not a component of the purchase cost of the car. However, these purchases should not be added to the purchase cost of the car, in accordance with VAT Notice 718, paragraph 2.6. Thus the output tax payable under the margin scheme is calculated using the difference between purchase price of £10,000 and sale price of £10,500, ignoring the parts. Thus the output tax payable is VAT on margin 7/47 x 500 = £74.47.

Potentially there could be PAYE implications in terms of selling the employee an asset at undervalue. Section 62(2)(b) ITEPA 2003 specifies that employment earnings include any profit or incidental benefit, in money or money's worth, obtained by an employee. We should be aware that the employee has purchased a car valued at £10,000, together with subsequent expenditure of £600, for a figure of £10,500. However, the £10,000 paid as a part exchange allowance may be greater than the true market value of the car purchased; generous part exchange allowances are often given to customers to encourage the sale of a new car. Further, Percy White notes that the stock item concerned was not easy to sell. Thus I believe we may ignore any PAYE implications in these circumstances.

(c) MOT testing

The ENG internal e-mail dated 28 October 2008 concerns MOT testing. This is a matter that needs to be dealt with urgently given the impending time limits. The VAT officer will expect a response in just under a fortnight, otherwise the client will have to consider an appeal to the VAT tribunal.

Misdirection

The officer intends to assess for a retrospective period of three years. The first issue to address is whether the client has a case to argue 'misdirection'. The client states that the existing arrangements were agreed at a VAT visit some five years ago, and that the company has carried out the same procedures ever since. Extra statutory concession 3.5 reads as follows:

"*If a Customs & Excise officer, with the full facts before him, has given a clear and unequivocal ruling on VAT in writing, or knowing the full facts, has misled a registered person to his detriment, any assessment of VAT due will be based on the correct ruling from the date the error was brought to the registered person's attention*".

Assuming the company can support its contentions, it has a common law right to restrict any assessment from applying from the date of the officer's recent visit. This may not be easy to argue. Furthermore the matter may not be appealed to the VAT Tribunal; rather a High Court hearing for judicial review would be required. However, if the circumstances are as stated, this concession should not be overlooked and should afford our client some protection.

Contractual arrangements

Turning now to the actual transactions made. The fundamental issue here is that when an Approved Testing Station charges a customer for MOT testing, such charge not exceeding the statutory maximum, it is outside the scope of VAT, as a service delivered under a statutory obligation.

The officer has mentioned the making of secret profits. The crucial issue here is the legal arrangements for the provision of MOT services, which customers receive through ENG rather than direct from the MOT testing station.

If ENG contracts with its customer to procure an MOT test for the customer, and ENG then has a sub-contract relationship with the Testing Station, to which ENG (and not the car owner) is alone the contracting party with the Testing Station, then his resultant service is to "procure an MOT test for a customer" and the whole of the £44 would be treated as the VAT inclusive fee. Such an arrangement would be the back to back contracts to which the VAT officer refers, and the £10 administration charge retained by ENG would be the secret profit. HM Revenue & Customs would regard the £10 as a discount offered by the Testing Station as an incentive for the garage to pass business its way.

If instead ENG acts as agent for the customer, booking an MOT test for the customer on his/her behalf, so that there is implicitly a contract between the customer and the Approved Testing Station for the performance of the test, which the test centre performs as principal, ENG's service is confined to the agency service alone. Accordingly on this legal structure, VAT is only due in respect of the £10 administration fee out of which ENG already accounts for VAT.

Before this second possible VAT analysis can be adopted, however, the various tests for demonstrating that an agent has met disbursements on behalf of his principal must also be demonstrated, in accordance with Para 25.1 of VAT Notice 700.

The main conditions relating to disbursements to be satisfied are as follows:

- The agent must act for his client when paying the third party,
- The client must actually receive the goods and services provided by the third party,
- The client must be responsible for paying the third party,
- The client must authorise the agent to keep the payment on his behalf,
- The client should be aware that the goods or services would be provided by the third party,
- The agent's outlay must be separately itemised when invoicing the client,
- The agent must recovery only the exact amount paid to the third party.

Further details specific to MOT tests are set out in Business Brief 21/96, which has represented HM Revenue & Customs' policy in this area for the last 12 years.

Thus the garage's customer must be invoiced correctly. In these circumstances, correct invoicing would involve splitting out the £44. This would be between ENG's charge for £10, inclusive of VAT (identifying the basic charge and the VAT payable within the £10), and the balance of £34, being an "agency disbursement". According to this reasoning, the MOT testing station should also change its invoices to show that the change for the test is the "discounted" £34 which is then passed on exactly.

In favour of ENG's position is the fact that it invoices its customers and the testing stations separately. Also the payments are not netted off in any way.

Strictly, HM Revenue & Customs could argue that the client should keep the administration fees from customers in separate trust accounts. Furthermore, it is also important that ENG has a notice in the garage explaining to customers the arrangements in force for the agency.

Without sight of all the paperwork, I cannot give definitive advice. I suspect that ENG would probably have a strong argument in resisting the VAT officer's challenge. You should note that there have been a few VAT tribunal cases recently found in favour of the taxpayer. In these cases the guidance provided in HMRC BB 21/96 has been criticised as being confusing and unhelpful.

Finally, for information, the VAT that the officer is seeking to collect for each MOT test would be calculated as follows:

	Fee	*VAT @ 7/47*
	£	£
Administration charge – output tax charged	(10.00)	(1.49)
MOT fee charge to customer	44.00	6.55
Additional tax claimed by HMRC		5.06

We will need to contact the client as soon as possible, in order to establish all the facts. Thereafter, with the client's consent, I will write to the VAT officer on behalf of ENG in the next few days.

Conclusion

I appreciate that there are a various number of issues here, and I would be happy to provide any further information or clarification as required. Note again that an urgent reply will be needed in respect of MOT testing to comply with the VAT officer's deadlines.

Regards

Chris

Further credit will be given to candidates discussing relevant tribunal cases such as *Jamieson*, decision 20269 and *KJ Lower and SJ Lower*, decision 20567.

Question 5

Part 1

Harvest Moon Tax Advisers
La Vern
Hightown H9 1AD
7 November 2008

A.Bouchard
Chief Executive
Chingstein Chamber of Commerce
ME 262
Dharma Way
Chingstein

Dear Allen

TRADING IN THE EU

Thank you for your letter of 4 November 2008, addressed to Sandy Pearlman. I am pleased that the seminar seemed to have been well received. Mr Bloom of Stalk Forrest Group has requested some initial advice from us and we will keep you informed of progress.

As requested, I set out below some brief details in respect of the introduction of Authorised Economic Operators in the EU.

Introduction

The Authorised Economic Operator (AEO) certificate is an internationally recognised quality mark which tells people that your role in the international supply chain is secure, and that your customs controls and procedures are efficient and compliant. The legislation came into effect in January 2008, though the UK began taking applications for AEO status from July 2007.

With an AEO certificate businesses can be considered as reliable trading partners. In addition to the marketing advantage, there are also administrative benefits in becoming an AEO. AEOs gain quicker access to certain simplified customs procedures, and may have the opportunity to "fast-track" shipments through certain HM Revenue & Customs (HMRC) safety and security procedures.

Types of AEO certificate

There are three types of certificates available:

- Customs Simplifications AEOs will in future be entitled to benefit from simplifications provided for under the customs rules.
- Security and Safety AEOs in future will be entitled to benefit from facilitations of customs controls relating to security and safety at the import/export of goods into, or out of, the customs territory of the Community.
- Customs Simplifications/Security and Safety AEOs will be entitled to benefit from both of the above (the "full certificate").

HM Revenue & Customs will generally recommend that businesses apply for the full certificate in order to receive the full benefits and avoid having to reapply later for the additional certificate.

Whichever certificate held, AEOs benefit from:

- a recognised status across the EC; and
- an industry "kite mark" which is a useful marketing tool

To become an AEO, you have to meet certain criteria relating to the reliability of your customs related operations throughout the EU.

In order to be able to apply for an AEO certificate, the business must be established in the EU (unless it is an airline or shipping company).

Operators intending to apply must be:

- financially solvent;
- compliant;
- able to demonstrate satisfactory management systems; and
- if applying for the security status, compliant in respect of security and safety standards

As part of the approval process, other EU Member States are contacted regarding the application. In introducing the new arrangements, there is a two year transitional period from 1 January 2008. During this time, the consultation period consists of 70 calendar days from the date the application is referred to them, for applications involving operations solely within the UK, and 120 calendar days where the customs authority in other Member States is required to carry out checks on the applicant's operations in their Member State.

It should be noted that once awarded the certificate can be suspended in respect of non compliance or revoked in respect of serious breaches of the conditions. Any revocation would apply throughout the EU and it would not be possible to reapply for a certificate for 3 years following the revocation, though it is possible to appeal against a suspension or a revocation.

I hope that the above is a useful brief introduction to the area. If any of your members require further information or assistance, please do not hesitate to contact me.

Yours Sincerely

Suzy Charles

Tax Manager

Part 2

Harvest Moon Tax Advisers
La Vern
Hightown H9 1AD
7 November 2008

Mr E. Bloom
Stalk Forrest Group
Redcap
Chingstein

Dear Eric

TRADING IN THE UK

I refer to our previous discussions at the Chingstein Chamber of Commerce seminar and as agreed write in relation to the various points discussed. In principle, we would be pleased to assist you with regard to setting up in the UK. There are however a number of formalities that need to be gone through before we can act on your behalf.

New Client Procedures

As part of our new client procedures, and prior to providing formal advice, we are obliged to set out our formal terms of reference in the enclosed letter of engagement. Please note that this has been prepared on the basis that you wish us to act as VAT agent for you (see below). If this is not the case, please let me know as we will need to reassess the nature of our role.

The letter also sets out our obligations under the UK money laundering provisions, which include the *Proceeds of Crime Act 2002* and the *Money Laundering Regulations 2003 and 2007.* These regulations require us to obtain evidence of prospective clients' identities and you will see at Appendix 1 the information required, which will include a reference from the Chamber of Commerce, which I am sure will not be an issue. We are also generally required to inform your existing advisers of our appointment and I should be grateful for your permission to write to them.

I would draw your attention to Clause 11 of the attached terms of reference (Appendix 2) which sets out the capping of our liability in respect of any actions taken against us.

Please review the letter carefully and if there are any points that you wish to discuss further, please do not hesitate to contact me. If you are happy with the terms, please sign and return a copy to me. Please be aware that until the letter is signed we will not be held accountable for any advice provided and consequently the information provided in the rest of this letter should be regarded as for general advisory purposes only rather than as specific advice or recommendations.

Commission Payments

Under our professional standards, we are required to inform you that we would make a payment of 10% of our first year's fee to the Chamber of Commerce in Chingstein by way of commission for the introduction. I understand that you are aware that this is part of the Chamber's standard practice.

VAT Representative

If you are trading within the UK, then as set out below, you are likely to require a VAT registration. In common with the majority of advisers in the UK, we do not take on the role of VAT representatives due to the fact that such a role would require us to be jointly and severally liable for the VAT debts of our principals. Consequently, we are unable to accept this role. We would however be pleased to accept the role of VAT agent in your dealings with HM Revenue & Customs. In acting in this role, you should be aware that you remain liable for any debts due to HM Revenue & Customs and for ensuring the accuracy of the information that we submit on your behalf.

VAT Registration

Where you are making supplies (i.e. sales) of goods or services in the UK over the VAT registration limit (currently £67,000) then you would be required to be VAT registered in the UK. If it was simply the case that you were selling from Chingstein to customers in the UK, and they were acting as importing the goods, then registration would not be required as you would not be making supplies in the UK. Where however stock is brought into the UK and sales fulfilled from stock that is already situated here, then it is likely that a VAT registration would be required.

You will be required to complete a VAT registration form, although we will prepare the majority of this on your behalf. Also, in order to be able to deal with HM Revenue & Customs on your behalf, we will need a signed letter of authority from you; a copy of which is enclosed.

Alternative to VAT Registration

If you would prefer not to register within the UK, it is possible to appoint a UK resident agent, registered for VAT to import and supply the goods as a principal. In order to be able to do this, Stalk Forrest group must be an overseas trader not registered for VAT in the UK who:

- imports goods for onward supply in the UK, and
- does not supply any other goods or services within the UK to a total value exceeding the current registration limit (currently £67,000).

Consequently, if you do bring stock into the UK and sell it from here above the registration limits, this option will not be available.

The agent will make the necessary Customs entries as the importer, pay or defer the VAT and Customs Duty as appropriate, and take delivery of the goods. The import agent claims the import VAT subject to the usual rules of evidence and must issue VAT invoices for the supplies of the goods, accounting for the VAT on the onward sale in the normal way. Generally, the agent's commission is subsumed within the onward supply to the customer rather than being invoiced to you separately.

Our firm does not act as import agent but if you are interested in this alternative, we would be pleased to suggest some potential providers that we could put you in touch with. Obviously, given their greater involvement in the process, the commission rates are liable to be higher than those of a VAT agent.

Bringing goods into the EU

Within the EU most goods are in free circulation. Goods in free circulation in the EU can be moved from country to country with minimal customs control. Unless the goods are subject to excise duty, (e.g. alcohol), or licence requirements such as agricultural goods, they generally cross borders without any special taxes or paperwork.

It should be noted that meat products will be subject to special licences. Department for Environment, Food and Rural Affairs (Defra) licences are required for importing meat, poultry, milk and other foodstuffs, livestock, blood, plant life, endangered species and fur. Imports of goods such as meat, poultry, dairy products (including milk and eggs), animal bones or blood, sausage skins and fishery products must undergo veterinary health checks at a Border Inspection Post (BIP) on arrival in the UK. If your products fail any of these checks, they will not be allowed into the UK and may be destroyed. If your products pass the checks, you will be issued with a Common Veterinary Entry Document (CVED).

(N.B. The above regarding licences is additional information and not required in order to gain full marks, though a bonus mark will be given for mentioning.)

There are strict rules on importing red meat, poultry, farmed and wild game and foods containing these.

Each batch (or 'consignment') of meat, poultry or wild game imported must:

- come from a country approved to export that type of product to the EU;
- be accompanied by animal health and public health certification;
- come from EU-approved premises; and
- enter the EU through a Border Inspection Post (BIP) where veterinary checks must be carried out. These are operated by local port health authorities and food enforcement officers from local authorities.

The identity and documentation (such as veterinary health certificates) of all these products are checked. Some products will also be checked physically. This might include looking, smelling or tasting the food, testing temperatures, checking wrapping and labelling, or laboratory testing. These controls are the same throughout the EU.

When goods come into the EU from outside it is necessary to make an import declaration to customs, and import duty and VAT will be due, although it may be possible to either suspend this requirement or obtain complete relief. It may also be the case that the imports are subject to import quotas, depending upon the type of goods and the location that they are imported from.

Once the goods are within the EU, it is then necessary to consider the VAT implications of moving goods between Member States. Generally sales between businesses in different EU member states will not be subject to VAT but there are detailed record keeping requirements to satisfy in terms of documenting the despatches and acquisitions in the other member states. There should however be no further customs duty implications, although it will be necessary via your labelling and other documentation to show an audit trail of the food's origins.

Imports from outside the EU into the UK must be declared to HM Revenue & Customs (HMRC). This is usually done using the Single Administrative Document (SAD), also known as form C88. SADs can be submitted either electronically using the Customs Handling of Import and Export Freight (CHIEF) system, or manually (although manual submissions may take longer to process). Traders find CHIEF useful because it sends all information relating to their imports and exports electronically to HMRC. CHIEF calculates duties, currency and quantity conversions, and provides an automatic clearance of consignments. In order to use the CHIEF system a

Trader Unique Reference Number (TURN) is required. This is usually the VAT registration number plus a three digit suffix. If you are not VAT registered then an alternative (known as a “pseudo TURN”) can be obtained.

To make the declaration the correct customs classification is required. This is set out in a Tariff which identifies all of the commodity codes and the rates of duty payable. The declaration also includes a customs procedure code explaining what is being done with the goods, Together with the commodity code, this helps determine what rate or type of import duty is to be charged and how the goods are to be treated.

An agent, such as a freight forwarder, can be used to make the declaration on the importer’s behalf. This can make importing simpler and faster if the importer is not itself authorised to make electronic declarations.

Imports are likely to be liable to import duty, depending on the classification of the goods and where they come from. The goods might also be liable to additional duties such as anti-dumping duties.

When you import goods, you must declare a value (known as the customs value) on the C88. It is important that this value is correct as this is the amount on which any duties and VAT due will be calculated. The customs value is also crucial to obtaining accurate trade statistics.

Where the goods you are importing are subject to a sale, the customs value should be based on the CIF price (cost, insurance, freight) plus certain other costs you may have incurred in purchasing the goods (e.g. some commissions, royalty and licence fees and even the value of materials you have supplied free of charge to a manufacturer). This method of valuation is known as the transaction value and is used in the vast majority of importations.

A reduced or zero rate of import duty can be paid on imports of certain goods from some countries, though there may be a limited annual quota. It is generally necessary to provide documentary proof showing where the imports originated from.

VAT

VAT is charged on goods imported from outside the European Union at the same rate as if the goods were purchased in the UK. This is usually at 17.5% but should be at 0% in the UK for your meat products. It should be noted that VAT is applied to meat in other EU member states, usually at a reduced rate (e.g. 5%).

VAT registered businesses can reclaim the VAT paid as input tax through their VAT returns in the same way as VAT is paid on UK purchases.

Instead of paying VAT to the supplier, the importer pays the VAT directly to HMRC. The importer (or its agent) will have to fill out HMRC's C79 form, showing the VAT paid. This form can then be used as evidence of the VAT paid, which enables recovery on the VAT return.

VAT & Duty Deferment

Imported goods are not normally released by customs until the duty and VAT have been paid.

It is however possible to set up a deferment account with HMRC, which allows the VAT and duty to be paid monthly in arrears rather than at the point of entry into the country. In practice, this can give up to six weeks cashflow advantage and provide administrative savings as the processing of imports is easier. A financial guarantee from a bank, insurance company or building society must be provided to cover the charges owed. Such guarantees would generally be for twice the amount generally imported in a month.

Delaying liability

Depending on the importer’s circumstances, it may be possible to delay the liability to import duty or VAT.

If the imported goods are not needed immediately, or they are to be re-exported, they can be stored in an authorised customs warehouse (see below). In such circumstances, the import duty or VAT does not have to be paid until the goods are moved into free circulation.

Similar rules apply for goods held in one of the UK's designated Free Zones. A Free Zone is a holding area for non-EU goods where import duty and VAT are suspended or delayed until the goods are released into free circulation.

Other Reliefs

There are a number of customs procedures that can benefit traders who plan to send their goods out of the UK. If goods are imported that are to be later exported or re-exported, it may be possible to claim relief from customs charges due on importation.

Temporary imports

If goods are to be temporarily imported for use, relief from import duty or VAT may be available provided the goods will remain in the same condition as they are imported, e.g. goods for demonstration, professional equipment, samples, goods for an exhibition or for humanitarian purposes. One method of temporary import is the ATA carnet. The carnet is issued in the country of dispatch usually by local chambers of commerce and industry and is used in place of customs documents normally required at import and/or re-export. ATA carnets are only applicable in countries which are signatories to the ATA carnet or Istanbul Conventions.

These reliefs cannot be used for goods that are to be processed before re-exporting. However, minor handling is permitted to preserve the goods and prevent their deterioration.

Processing and re-exporting

If goods are to be imported, processed and then exported, Inward Processing Relief (IPR) can be claimed. There are two methods of duty relief - suspension and drawback. IPR suspension allows the trader to import and process the goods while suspending duty and VAT payments. With IPR drawback, duty and VAT is paid on importation but can be reclaimed. The trader must be authorised by HMRC to claim these reliefs.

Whilst this may not be wholly relevant for the main meat products, it may be in issue if you decide to start making pie or sausage products. Obviously, if there is some degree of processing of the refrigeration parts then this would also be relevant.

Onward supply to the European Union

Where goods are imported that are to be supplied to another EU member state Onward Supply Relief (OSR) may be claimed. This allows the trader to import the goods without paying import VAT. Instead, VAT is paid when the goods are supplied to the customer.

Relief for goods used in certain ways

There are several special reliefs that may apply to particular circumstances. For example:

- imported goods for charities, goods for exhibitions, and low-value samples, are free of duty; and
- scientific goods to be used in tests can be imported free of duty and VAT.

Whilst these reliefs may not be wholly relevant, it is possible that they could apply if you decide to bring in some initial low value samples, or attend food exhibitions.

Where goods are imported to process into a product that carries a lower rate of import duty than the imported goods, the trader can apply for processing under customs control (PCC) and pay duty on the lower rate applicable to the processed goods. Using the PCC arrangements, it is possible to:

- import goods from outside the EC with all customs charges suspended;
- process them in the trader's own premises, or have them processed for the trader; and
- pay duty at the rate which applies to the processed products (rather than the imported goods) when they are put into free circulation.

It is possible to import goods directly to the PCC arrangements, or transfer goods into PCC from another customs procedure, such as customs warehousing. Before entering goods to PCC, the trader must be authorised to use the arrangements. The trader must have a permanent establishment in the EU to use this relief. Again, this would be dependent upon the amount of processing that you intend to undertake with the meat.

Customs Warehousing

You mentioned when we met that this was an area that your export manager would be interested in and so I have set this out in more detail.

Generally meat, meat products and other goods subject to the Veterinary Checks regime cannot be subject to customs warehousing unless the required import licence and/or health certificate have been presented and veterinary checks have been completed at the frontier. Consequently, in order to be able to use customs warehousing for this part of the business, it will be necessary to ensure that the necessary licences are obtained.

Customs warehousing is particularly useful if you:

- want to delay paying import duty and/or VAT on your stocks of imported goods;
- want to delay having a customs treatment applied to imported goods;
- want to re-export non-Community goods (in which case import duty and/or VAT may not be payable at all);
- have difficulty at the time of import in meeting particular conditions (such as certain import licensing requirements);
- want to discharge another customs procedure (such as Inward Processing Relief ("IPR")) without physically exporting the goods; or
- want to use a customs warehouse for co-storage of goods subject to another customs procedure (such as IPR, or Processing under Customs Control ("PCC")).

With customs warehousing, the import duty and VAT is not payable until the goods leave the warehouse. If the meat products qualify for zero rating in the UK then no import VAT will be payable and so it is primarily the customs duty that we are looking at by way of benefit. Obviously with meat products having a shorter shelf life the benefit of holding them for a period of time in a customs warehouse would need to be assessed, although they would obviously be stored in the refrigerated units.

A customs warehouse can either be a defined location (such as premises or place) or an inventory system authorised by HM Revenue & Customs for storing non-Community goods that are:

- chargeable with import duty and/or VAT; or
- otherwise not in free circulation.

Depending on the circumstances, a defined location can be the whole of a building, a small compartment in a building, an open site, a silo or a storage tank.

A customs warehouse can be either a **public** or a **private** warehouse. A **public** warehouse is authorised for use by warehouse keepers whose main business is the storage of goods deposited by other traders (depositors). A **private** warehouse is for the storage of goods deposited by an individual trader authorised as the warehouse keeper. The warehouse keeper need not necessarily own the goods but must be the depositor.

- In the UK it is possible to have the following types of customs warehouse: types A, C, D & E. These differ as follows:
- Type A - public warehouse;
- Type C - basic private warehouse;
- Type D - An alternative private warehouse, appropriate to traders who primarily import goods for free circulation; and
- Type E - Another form of private warehouse in which a company and its commercial accounting and stock control systems are authorised rather than a defined location.

For type E authorisations, the goods may be stored at any notified storage site/facility belonging to the authorised trader whereas with the other types the physical locations are defined. The authorised trader of a type E warehouse need not physically own the storage site and it can include the premises of a type A, C or D warehouse. However, the authorised trader must have control over the goods whilst they are stored at those sites and must have access to them at all times.

Retail sales are prohibited in a customs warehouse. This includes goods under the type E warehousing arrangements.

Sales or other supplies of imported goods which remain within the customs warehousing arrangements are disregarded for VAT purposes provided the sales or supplies take place before removal to free circulation or, where both customs and excise duty are chargeable, before removal to home use.

Which type of warehouse?

The initial issue to address is whether you want the responsibility of being a warehouse keeper or to simply use a public warehouse. A warehouse keeper is responsible for:

- the security and proper control of the warehoused goods, including maintaining stock records for those goods throughout the customs warehousing procedure and accounting for any shortage;
- ensuring that the conditions of the customs warehouse authorisation and all HM Revenue & Customs' obligations are met;
- fully co-operating with HM Revenue & Customs in their supervision of your authorisation; and
- allowing HM Revenue & Customs access to the warehouse premises, your warehouse records and to the warehoused goods at all reasonable times.

If you decide that you do not wish to have the above responsibilities, then it would be a case of using type A, the public warehouse. In this way you would be a depositor in the public warehouse but still benefit from customs warehousing.

If a private warehouse is preferred then it is a matter of determining which is the most suitable:

Type C: With this, only the warehouse keeper can store goods and this is the same person as the depositor but is not necessarily the owner of the goods.

Type D: Again, only the warehouse keeper can store his goods, where the warehouse keeper is the same person as the depositor but is not necessarily the owner of the goods. In contrast with the other warehouse types the Import Duties are calculated based on the rules of assessment ascertained or accepted at the time when the goods are placed in the customs warehouse system. This type of warehouse is quite similar to a type C warehouse.

Type E: As described above, this type of warehouse is based on the warehouse keeper's records rather than a physical location. This type of warehousing requires a high level of administrative organisation including inventory records, as the physical location of the goods is not the key factor, but the fact that the goods are entered in the warehouse records. HM Revenue & Customs must be able to follow the goods through the records system. This type of warehouse is the most sophisticated type which gives maximum flexibility to the warehouse keeper, but also requires a high level records system.

At this stage it is probably a case of determining whether a public or private warehouse is preferred, and if private, the degree and sophistication of the records that are to be kept.

You must keep your stock records and any associated documentation for at least 4 years after the date of removal of the goods from the customs warehousing arrangements. If convenient, you can use a microfilm or computer medium but you must produce these records in a legible form on request and allow HM Revenue & Customs to take copies as required. The stock records must be kept at the warehouse premises for types A, C and D warehouses and at the company's Head Office for type E unless HM Revenue & Customs allow otherwise.

Normally your commercial records will be sufficient, but HM Revenue & Customs may require you to adapt them for their control purposes.

Detailed provisions need to be satisfied to order to obtain authorisation for customs warehousing, and as stated, these are more even more specific in respect of the type E warehouse. Before HM Revenue & Customs authorise a new customs warehouse they must be satisfied that:

- the applicant is established in the European Community;
- the warehouse is intended to be used primarily for the storage of goods;
- there is a genuine economic need for such facilities, either sufficient potential trade for a public warehouse to be viable or sufficient benefits to the applicant for a private warehouse (such as the amount of re-exports);
- the applicant is able to comply with the conditions of authorisation; and
- HM Revenue & Customs have sufficient resources to oversee the setting up of the customs warehouse and also to carry out the necessary checks on the warehouse keeper's control systems and records and on the goods stored.

I hope that the above provides you with some initial guidance as to the options available, and no doubt we will discuss the matter in greater detail in the future when we can make more definite recommendations on the best solution for your requirements.

Yours Sincerely

Sandy Pearlman

Partner