THE CHARTERED INSTITUTE OF TAXATION

The Chartered Tax Adviser Examination

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PAPER III – INTERACTION OF TAXES

Suggested Answers

Question 1

Report for Anne & Dan Yellow

Taxation & Legal Implications of Dissolving ADY Ltd

Introduction

This report has been prepared to cover the issues arising from the proposed dissolution of ADY Ltd (`ADYL`) a company equally owned by Anne Yellow (`AY`) and her brother Dan Yellow (`DY`).

It considers the principal tax implications arising for both ADYL and AY/DY. It also briefly explains and compares how the company dissolution could be effected.

Facts

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

Taxation Implications for ADYL

General Implications of Ceasing to Trade/Commencing Winding Up

The cessation of the company`s trade and/or the commencement of the winding up will trigger the end of an accounting period (`AP`). In this case it is expected that both of these will be on the same date. ADYL will therefore have a short (6 month) AP to 30 September 2008. After this an AP will end every 12 months except the last one which will end with the completion of the winding up.

The cessation of trade for ADYL will have a number of other important tax consequences:-

- This will accelerate the corporation tax payment date (being 9 months and 1 day after the end of any AP for a company not paying corporation tax in instalments) although in this case, with losses being available, it is unlikely that there will be any corporation tax liability.
- There will be a deemed disposal of plant & machinery for capital allowances purposes resulting in either a balancing charge which will increase trading profits or a balancing allowance which will decrease them. If the plant is sold before or shortly after the trade ceases the disposal value brought into account is likely to be the actual net sales proceeds (see calculations later). No writing down allowances will be available for the period to 30 September 2008.
- The cessation of trade will not in itself trigger a balancing adjustment for IBA purposes. Indeed as the disposal of the factory will occur after 21 March 2007 no balancing adjustment will now arise following s36 FA 2007. To qualify for writing down allowances, however, it is a requirement that an industrial building is in use for industrial purposes at the end of an AP. As ADWL will have ceased trading it would be difficult to argue that the building remains in industrial use. It therefore seems unlikely that the company will be eligible for any IBAs for the AP to 30 September 2008 and subsequent APs. It would appear therefore that IBAs do not need to be considered further.
- If the company`s stock is sold to an unconnected `arms length` person any actual sale proceeds will be credited in the final trading account. In these circumstances HMRC will not be able to substitute a market value.
- ADYL is clearly a close company (only 2 participators). Where a close company ceases to trade it will usually be classed as a close investment holding company (`CIHC`). CIHCs generally pay corporation tax at the full rate and do not get the benefit of the small company`s rate or marginal relief. Because ADYL was not, however, a CIHC throughout the AP in which it commenced its winding up (ie the AP to 30 September 2008) it will not be treated as a CIHC for the next AP (ie year to 30 September 2009 or period to the completion of winding up if earlier). It is likely therefore that ADYL would be eligible for the small companies' corporation tax rate on any chargeable profits incurred in the AP to 30 September 2009.
- Trading losses can only be carried forward against future profits from the *same* trade. ADYL will not therefore be able to use any losses against any chargeable profits including capital gains generated after the cessation of trade on 30 September 2008 (see `use of losses` section below).

Provisions etc.

Any expenses incurred after the cessation of trade can only be relieved against post cessation receipts. This could restrict the potential for relieving such expenses which may therefore remain unrelieved. In drawing up the final trading accounts it is important therefore to fully consider and incorporate appropriate specific provisions for all trade related expenditure incurred up to the date of cessation. In this particular case care should therefore be taken to include a specific provision for the bad debt arising from the sale of the defective goods (probably the full £10,000) as well as the customer`s repair bill. With regards the latter case law dictates a provision should be tax deductible if:

(i) under generally accepted accounting principles profits would be inaccurately stated in the absence of a provision; and

(ii) it has been possible to arrive at a sufficiently reliable figure. The best available evidence at the present time seems to point towards a figure of £2,500 although this should be subject to review up to the submission of the corporation tax computations for the period ended 30 September 2008 (which would not need to be submitted until 30 September 2009).

To obtain relief for pension contributions they need to be physically paid by the end of a particular AP. Provided the contributions are paid in the final trading AP a deduction can usually be obtained. It would therefore be important that the £25,000 premium is paid before 30 September 2008.

S77-79 ITOIA 2005 specifically relieves statutory redundancy payments and additional payments up to three times the statutory amount. Even if paid after the cessation of trade these will be treated as paid on the last day of trading. There should be no problem in obtaining a deduction therefore for £7,500 of the £10,000 additional sum paid to the former manager. The remaining £2,500, being non-contractual, in nature is likely to be disallowed unless it can be claimed on first principle `wholly & exclusively` grounds.

Use of Losses

Appendix I provides a computation of the expected tax adjusted loss for the AP to 30 September 2008 amounting to £201,500. This is in addition to the trading loss incurred in the year ended 31 March 2008 amounting to £78,094. Total trading losses which are currently unrelieved therefore amount to £279,594. Clearly because these losses cannot be used against any profits generated after 30 September 2008 it is important to:

(i) minimise profits from arising after this date; and

(ii) maximise the use of these losses against profits generated before this.

The potential loss reliefs available to ADYL are:

s393A(1)(a) ICTA 1988	–	offset against other profits in the same AP.
s393A(1)(b)	–	offset any remaining losses against profits of previous 12 months after deducting trade charges and
s393A(2A)-(2B)	–	losses arising in the last 12 months of trading offset against profits after deducting trade charges of the previous 36 months on a LIFO basis. This is commonly known as a terminal loss relief.

The loss for the earlier year to 31 March 2008 should be dealt with first. As there is no other income in this year the only possibility here will be to carry £13,024 of this loss back against the profits for the 12 month AP ended 31 March 2007. This claim needs to be made by 31 March 2010 and should result in the refund of the corporation tax paid for the AP to 31 March 2007 amounting to £2,475. At this point £65,070 of the total loss for the AP to 31 March 2008 remains unrelieved.

Appendix II shows that the sale of the freehold factory is expected to generate a chargeable gain in the order of £95,000. If this took place after ADYL has ceased trading it would not be possible to relieve this gain with the trading losses as they cannot be used against any post cessation profits. Every effort should therefore be made to dispose of the factory in the AP to 30 September 2008 in which case it would be possible to offset losses against the gain under s393A(1)(a). AY already has a significant property portfolio so, particularly because the factory is considered marketable, she may consider the purchase of this property herself before ADYL ceases to trade. It is noted that AY is already owed £400,000 by ADYL so this could be used to part fund the purchase.

Because AY and ADYL are connected this transaction should take place at the market value of £750,000. This will avoid such tax complications as a deemed distribution (or potential employment income consequences) if the sale took place at undervalue. AY would have an SDLT liability of £30,000 (ie £750,000 x 4%).

Assuming this occurs the loss claims would be:-

£95,000 of the total loss of £201,500 is offset in the short AP to 30 September 2008 leaving £106,500 unrelieved. The only way these remaining losses could be used is by making a terminal loss claim. Because this applies to losses arising in the last 12 months of trading 6/12 of the residual losses for the AP to 31 March 2008 can also be included.

The losses should be dealt with chronologically as two separate losses rather than as a single loss arising in the last 12 months. The losses arising from the last 12 months can be carried back for 36 months from the start of the accounting period in which the loss arose.

- 6/12 of the unrelieved loss arising in the AP to 31 March 2008 (£65,070/2 = £32,535) can be carried back to the AP ended 31 March 2005 ie against all profits since 1 April 2004.
- The unrelieved loss arising in the AP to 30 September 2008 (£106,500) can also be carried back to the AP ended 31 March 2006 ie against all profits since 1 April 2005.

This can be carried back as follows:-

AP Year to 31/3	2005	2006	2007	2008
No of months c/b (loss of Y/E 31/3/08)	12	12	12	6
No of months c/b (loss of P/E 30/9/08)		12	12	12
Chargeable profits	190,564	75,078	Nil	Nil
Terminal loss relief (loss of Y/E 31/3/08)		(35,235)		
Terminal loss relief (loss of P/E 30/9/08)		(39,843)		
	190,564	Nil	Nil	Nil

This should generate further corporation tax refunds at 19% of £14,265
The loss in the AP to 31 March 2008 is thus used as follows:

	£
Loss arising in Y/E 31 March 2008	(78,094)
Prior year claim s393A(1)(b)	13,024
TLR claim s332A(2A)	35,235
Loss remaining unrelieved	(29,835)

The loss in the AP to 30 September 2008 is thus used as follows:

	£
Loss arising in P/E 30 September 2008	(201,500)
Current year claim s393A(1)(a)	95,000
TLR claim s332A(2A)	39,843
Loss remaining unrelieved	(66,657)

If the factory sale takes place in the year after 30 September 2008 the only way the residual losses (ie in this case £234,035 (201,500 + (65,070/2)) can be relieved is by making the same terminal loss claim. Although the losses of the period ended 30 September 2008 would be higher, they could still only be carried back as far as the AP ended 31 March 2006 only. It would leave a corporation tax liability on the gain of £19,950 (£95,000 x 21%). This would be payable by 9 months and 1 day after the end of the chargeable accounting period in which the factory was sold ie 1 July 2010 if sold in the year ended 30 September 2009. It would also leave additional unrelieved losses of £95,000 unrelieved. It is therefore imperative that the factory sale takes place in the period ended 30 September 2008.

Value Added Tax

ADYL should inform HMRC within 30 days of the cessation of trade and deregister for VAT purposes. With the exception of the property which will be an exempt supply (not subject to an option to tax election) there will be a requirement to account for VAT on the disposal of assets/assets left on hand at deregistration. Any VAT charged on expenses relating to the disposal of the property will only be recoverable if permitted under the partial exemption de-minimis rules.

It should be possible to obtain input tax relief for any post cessation expenses (eg professional fees) by completing a Form VAT 426. This could also be used to obtain VAT relief for the bad debt (which can only be claimed after the debt has been written off for 6 months).

Effecting the Company Dissolution

There are basically two ways in which ADYL can be dissolved: a formal voluntary liquidation; or to apply to Companies House for the company to be struck off the register of companies it maintains.

Liquidation

A voluntary liquidation begins by a resolution of the members to wind up the company. There is no need to wait a certain period after the company has ceased trading. A liquidator is appointed to realise the company assets and pay all of its debts and then return any surplus capital to the shareholders. Once the assets of the company have been distributed the company is dissolved.

Under this route a company can only be restored to the Register within 2 years after the winding up has been completed. Thus a creditor only has a period of 2 years to make claims against the company. The costs of a formal liquidation can, however, be quite high.

Striking Off

Companies House has the power to strike a company off its register upon an application from the company shareholders being made. Under this route there is a need to wait three months after the company has ceased trading before Companies House will permit a striking off. In addition all shareholders, employees and creditors must be notified. Because in a solvent situation the company does not have to appoint a liquidator to strike off a company this method can, however, be considerably cheaper. Under ESC C16 HMRC will also usually treat a striking off dissolution as if it were a formal liquidation for taxation purposes (particularly relevant to distributions being treated as capital rather than income in nature).

If creditors emerge, however, they have up to 20 years (rather than just 2) to apply to restore the company to the register. It is also important that the company assets are distributed before the company is actually struck off by Companies House otherwise they will become `bona vacantia` (ie effectively pass to the Crown).

Taxation Implications for the shareholders

As shown in Appendix III approximately £225,000 of surplus funds is potentially available for distribution to AY and DY (ie £112,500 each). This assumes that the property is sold before 30 September 2008 possibly to AY as referred to above. It will be necessary to decide how this is best returned to the shareholders.

The basic distinction to consider is whether the distributions will be treated as capital or income in nature. In this regard it should be noted that distributions made in the course of a formal liquidation are treated as capital distributions and are therefore chargeable to CGT (and also access potential available CGT reliefs). In addition under ESC C16 HMRC will *treat* distributions (which under s209 ICTA 1988 are strictly income distributions) made after an application for a company to be struck off to Companies House has been made as capital distributions. To apply ESC C16 requires certain assurances to be made to HMRC which include that:

(i) that the company will provide any information required to determine and pay any final corporation tax liability;

(ii) the shareholders will pay any CGT liability on any amounts distributed to them and

(iii) that the company will cease trading in the future and will be dissolved.

It should be noted that the commencement of winding up in itself does not trigger any tax liabilities for AY and DY rather it is the date that any distributions are made that is relevant. It is perhaps also worth pointing out that the Treasury Solicitor`s website suggests that where a company is struck off and a distribution in excess of £4,000 is made it is possible that the Crown might seek these funds under the bona vacantia rules.

If the distributions are made prior to the commencement of the dissolution process (ie before it is resolved to formally liquidate the company or before any steps are taken to have the company struck off) they will therefore be treated as `normal` income distributions. As higher rate taxpayers AY and DY will therefore have an effective tax rate of 25% of the net dividend received ie £28,125 each (112,500 x 25%). This will be payable under the normal self-assessment system probably as part of any balancing payment due for the 2008/2009 tax year on 31 January 2010.

If the distributions are made after the commencement of the dissolution process they will be subject to CGT rules. The chargeable gain will be calculated as the difference between the distribution made and any available base cost. It should be noted that the shares were acquired by AY and DY in April 1996 at a base cost of £500 each. A small amount of indexation allowance will therefore be available (under pre Finance Bill 2008 rules) for the period to April 1998 amounting to £33 ((162.6-152.6)/152.6 x 500)). The basic gain will therefore be £111,967 (112,500 – 500 – 33).

If more than one capital distribution is made all but the final one will be treated as part disposals of the shares using the A/(A=B) formula (where `A` = the amount of interim capital distribution and `B` = the residual share value). In practice in most straightforward situations it is likely that the value `B` will simply be the sum of all capital distributions made after the one in question.

The effective tax rate under the capital distribution route is likely to be either:

10% ADYL appears to be a normal trading company with no/insignificant non-trading assets. As such shareholdings in ADYL are most likely to be regarded as business assets for CGT taper relief purposes. As the shares have been held for more than 2 years maximum 75% taper relief would be available giving an effective 10% rate (ie 40% x 75%). This will result in a tax liability of £11,197 each (111,967 x 10%) payable by 31 January 2010; or

18% Following the provisions introduced in the 2008 Finance Bill it is likely that the shares will qualify for entrepreneurs relief and thereby attract a CGT rate of 10% rather than the flat rate of 18%.This would result in a tax liability of £11,200 each (111,967 + 33 (indexation abolished) x 10%) again payable by 31 January 2010.

It should be noted that under the CGT taper relief provisions once the company has ceased trading it is possible that the shares may be regarded by HMRC as non-business in nature. To minimise the tainting of any taper relief otherwise available at business asset rates it may therefore be beneficial to make capital distributions as early as possible in the dissolution process. In this regard it is often possible to persuade a liquidator to make the maximum distribution available providing the shareholders are willing to provide an indemnity.

(NB Candidates will receive credit either by basing their answers only on the pre 5 April 2008 rules or by including reference to the new rules.)

Taking into account any available CGT annual exemptions for AY and DY the effective tax rate (and hence tax liabilities) may be further reduced.

Either way unless there are other reasons which may make an income distribution beneficial (eg the availability of income losses covering this income - which seems very unlikely in this case) the effective tax rate is likely to be lower under the capital distribution route compared to the 25% tax rate as an income distribution. It therefore seems likely that AY and DY will wish to pursue the capital route.

One final point concerns a consideration of s703 ICTA 1988. HMRC has stated that these anti-avoidance provisions will not apply in the case of an `ordinary` liquidation where there is a winding up for bona fide reasons particularly, as in this case, where a business has simply come to an end or been sold to an unconnected third party.

Before making any distributions AY and DY may also wish to consider taking advantage of the provisions within ss410-403 ITEPA 2003 which allow for the first £30,000 of any termination payments being exempt from income tax. It should be noted that any statutory redundancy entitlement will be deducted from the £30,000 limit and also that this will not exempt any payments taxable under normal employment income rules (eg if there is a contractual entitlement). AY and DY should, however, be warned that in situations where the recipients are shareholders capable of exercising a significant influence over the company HMRC is likely to argue that the payments should simply be treated as part of any distributions made.

AY and DY should also be informed that they will be replacing an asset (shareholdings in ADYL) which qualify for 100% business property relief for inheritance tax purposes with an asset (cash) which does not qualify for relief and which would be included within their estates.

Appendix I

Computation of the expected tax adjusted loss for ADYL for its AP to 30 September 2008.

	£	£
Loss per accounts		(134,000)
Less: Depreciation	20,000	
Balancing charges	10,100	
		30,100
Add: Balancing allowance	(4,600)	
Stock write off	(8,000)	
Bad debt provision	(10,000)	
Compensation provision	(2,500)	
Statutory redundancy	(40,000)	
Additional redundancy	(7,500)	
Pension premium	(25,000)	
		(97,600)
Trading Loss		(201,500)

Capital Allowances	Pool	Expensive Car
	£	£
TWDV b/f	24,900	14,600
Proceeds	(35,000)	(10,000)
Balancing charges	(10,100)	
Balancing allowance	–	4,600

Appendix II

Disposal of Freehold Factory

(assumed sold 30/9/2008)

	£	£
Proceeds		750,000
Less: Cost	500,000	
Indexation ((216.4-165.2)/165.2) = 0.310 x £500,000	155,000	(655,000)
Chargeable gain		95,000

Appendix III

Determination of Surplus Funds

	£	£
Realisation of company assets		
Property		750,000
Plant & machinery		45,000
Stock		2,000
Debtors		15,000
Corporation tax refunds:-		
AP 31/3/2007		2,475
AP 31/3/2006		14,265
		827,740
Company Liabilities		
Mortgage	100,000	
AY Loan account	400,000	
Other creditors	25,000	
Pension contributions	25,000	
Compensation claim	2,500	
Redundancy costs	50,000	(602,500)
Net Surplus		225,240

Say £225,000 (ie £112,500 each)

Question 2

Tax Adviser
Colmore Row
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Mr Terence Martin
25 Homestead Road
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B98 5TR

14 May 2008

Dear Terence

The Terence Martin Family Trust

Thank you for your letter of 1 May with enclosures.

It was good to meet you and I am glad that you found our meeting useful.

I have now had an opportunity to review the trust deed and consider the various matters that we discussed in the meeting, particularly those areas in which you followed up in your letter.

I will address each of the issues in turn in this letter.

Finance Act 2006 (FA 2006)

The trust deed shows that the trustees have the power to "accumulate any income so far as it is not applied for the maintenance, education or benefit of the beneficiaries". The beneficiaries receive a life interest at age 25, although they do not receive any entitlement to capital until age 40.

The trust in question is therefore a typical accumulation and maintenance (A&M) trust, which was historically a tax-favoured type of trust traditionally used to make provision for minor children.

Unfortunately changes made in FA 2006 took away many of the tax benefits associated with this kind of trust.

The main benefit of the A&M trust was the favourable inheritance tax (IHT) treatment. Any gifts into such a trust were potentially exempt transfers (PETs) which meant that there was no IHT on the way into the trust (providing the settlor survived for seven years) and there were no IHT charges in the trust itself.

From 6 April 2008, the trust has now entered into what is described as the “relevant property” regime, which means that these IHT breaks have effectively been removed. Going forward the trust will suffer ten yearly charges on the value of the relevant property in the trust above the nil rate band. This charge is around 6% every 10 years. The first ten year charge will be on 23 March 2010. However, as the trust will have been in the relevant property regime for only 2 years at this point, the 6% charge will be substantially reduced.

In addition, any distributions of capital from the trust will be subject to the IHT exit charge (see below).

It is also important to note that any additional funds that are added to the trust will constitute a chargeable lifetime transfer, which means an immediate 20% tax charge will arise on the way into trust to the extent that the transfer exceeds your available nil rate band (and annual exemptions, if available).

Self Assessment dates

Your late sister has historically prepared the trust tax return. However following her untimely death, you have asked us to take over provision of tax compliance services.

As a starting point, I will set out the key dates below and provide an overview of how the self assessment system works.

Trustees are subject to the same self-assessment rules as individuals in relation to their tax liabilities. They are required to make payments on account every half year on 31 January in the tax year and 31 July next, based on the previous year’s net income tax. A balancing payment, including any capital gain tax is payable on the following 31 January. This is also the due date for the submission of the tax return.

Trusts submit a special tax return (SA900) which is very similar to that of individuals, but requires additional information such as details of capital added to a settlement and capital payments made to beneficiaries.

For the tax year 2007/08, the trustees will be due to make a second payment on account on 31 July 2008 (this will have been calculated in the tax return for 2006/07). The first payment on account would already have been made on 31 January 2008. The balance of any tax due is payable on 31 January 2009, together with the first payment on account for 2008/09.

As this follows exactly the same principles as your personal tax return, hopefully, you will already be fairly familiar with these dates.

Income Tax Payable

For the year ended 5 April 2008, the income tax liability is £58,213. I attach the calculation of this liability in Appendix I.

There will also be a payment on account due for 2008/09, which is half of the 2007/08 liability.

Distributions to Beneficiaries

If the cash and shares are distributed to the beneficiaries, under the new rules there will be an exit charge based on the value of the property leaving the trust.

From the information provided, the shares in Bobbins Investments Limited would not appear to qualify for Business Property Relief and therefore, on distribution, their full value will become chargeable.

As the trust was not within the relevant property regime at the time of the last ten-yearly anniversary, it is necessary go back and recalculate the charge on the basis that the relevant property was worth £3.3m at that point. An exit charge is then calculated based on this notional ten-yearly charge, although it is reduced significantly as the trust has only been within the relevant property regime for 3 quarters by December 2008.

The exit charge due on the distributions would be £2,009. Detailed calculations are set out in Appendix II.

Where an exit charge arises, the trustees must submit a tax return called an ‘account’ which will be on Form IHT 110 and pay any tax arising.

The account must be delivered within 12 months after the end of the month in which the occasion to charge took place or, if later, at the end of a three month period beginning from the date on which the trustees became liable for tax.

By contrast the tax will normally be due earlier. If the chargeable event takes place after 5 April but before 1 October, the due date is 30 April the following year. If the chargeable event occurs after 30 September and before 6 April the tax is due 6 months after the end of the month in which the event occurred.

Therefore, if the distributions are made in December 2008, the tax will be due on 30 June 2009.

As the intention is for the majority of the cash to be used to purchase a home, the trustees might consider whether they should purchase a property, allowing Lisa to live in it as a beneficiary rather than distributing funds out of the trust. Taking this approach, might also provide an element of asset protection on divorce. However, it will depend upon Lisa being comfortable living in a property which was owned by the trustees rather than by her outright.

Another option would be for the trustees to lend the funds to Lisa and for her to purchase the property with these funds rather than distributing outright to her. The loan might be interest free.

Transferring properties into the trust

Commercial Property

You currently own a commercial property which you are considering transferring into the trust and you have asked me to briefly outline the taxation implications of making such a transfer.

Following the changes in FA 2006, transferring this property into the trust would constitute a chargeable transfer and as such 20% tax would be payable on the value above the available nil rate band (which is currently £262,000 as you have already used £50,000). Based on a value of £350,000, this means that there would be a tax charge (ignoring annual exemptions) of £17,600. However, it may be possible to pay this tax in ten yearly instalments.

Once in the trust, the value of the property will be subject to a 6% inheritance tax charge on every tenth anniversary of the trust under the 10 yearly charge regime. There will also be an inheritance tax charge if the property is distributed out of the trust. However, on the positive side making the transfer will take the value of the property outside your estate for IHT purposes which means there is potentially a 40% tax saving on your death.

As you recently bought the property and do not believe it has increased in value since purchase, there should not be any capital gain arising on the transfer. If there was any gain on the property, it would be possible to hold over (ie defer) the gain because the transfer is a chargeable event for IHT purposes. Therefore it would be possible to prevent a capital gain coming into charge even if the property has increased in value.

Under your current proposals, you will also need to consider the Stamp Duty Land Tax “SDLT” payable by the trustees on transfer into the trust. On purchase of the property, you will have already incurred SDLT costs of 3%.

On first principles there is no SDLT charge when property is transferred for nil consideration, which is the situation if you gift the property into the trust. However, for SDLT purposes, consideration also includes any debt assumed by the donee.

This means that if the trustees take over the £300,000 mortgage on the property, there will be an additional SDLT charge of 3% of that mortgage value, which results in an extra £12,000 tax charge. You might therefore want to consider whether it would be possible to transfer the property free of any encumbrances if you were to go ahead with the transfer.

Once the property is owned by the trust, the income will be received by the trustees. One third of this is due to Lisa as she has a life interest in one third of the trust's income. The other two thirds will be accumulated by the trustees and paid out to the other two beneficiaries at the trustee's discretion. The trustees' rate of tax on the accumulated share of the income is 40%. They will also pay 22% on Lisa's share of the income. She will pay any additional amount due, depending upon her marginal rate of tax.

If distributions are not currently made to the other beneficiaries, it would be worth considering making payments as they may be able to reclaim some of the tax paid depending upon their own taxation positions.

Unfortunately just because an asset is gifted, this does not mean that it automatically escapes VAT. The deemed supply rules treat the disposal of "business assets" as a supply irrespective of whether there is any consideration. This only applies to assets on which VAT has been reclaimed previously. It would therefore be useful if you could confirm the VAT status of the property so that we can apply the appropriate advice.

Holiday Home

You also mentioned in our meeting that you currently own a holiday home personally which you visit around 6 times a year. Your intention is to continue taking holidays there even after it has been given to the trust.

As you will not have given the asset away to be enjoyed entirely at your exclusion, the gift will potentially fall within the gift with reservation (GWR) rules. This would mean that the value of the property would remain in your estate for IHT purposes. In order to avoid the GWR provisions applying, it would be necessary for you to pay full market value rent to the trustees for the use of the holiday home.

If the gift is a GWR, the pre-owned assets (POA) rules will not apply. However, paying full market rent for use of the property does provide a layer of protection from the POA rules in the unlikely event that the gift of the property was not considered to be a GWR. The POA rules effectively apply an annual income tax charge on the benefit received, which can prove very expensive on an ongoing basis.

The transfer of the holiday home will be a chargeable transfer for IHT purposes. Assuming that you have transferred the commercial property and therefore used all of your nil rate band, the full value of the property will be chargeable at 20%, which results in a £70,000 tax charge.

Going forward, the value of the property would be subject to ten yearly charges within the trust. The ten yearly charge is around 6% of the value of the trust assets above the nil rate band and is due on each 10th anniversary of the trust. As the trust already has assets above the nil rate band, this means the full value of the property is likely to be taxed at 6% on every tenth anniversary of the trust.

You will see from the above analysis that this is a very tax inefficient transaction. If structured incorrectly you could suffer a £70,000 tax charge on the way into the trust, the value of the property could be subject to a 6% tax charge every 10 years and the full value could also fall into your estate to be taxed at 40% on death.

For capital gains tax purposes, the gain inherent in the property, around £165,000, could be held over. This means that the trustees will take over the original cost of the property and the gain will be taxable on eventual sale of the property rather than on transfer.

For income tax purposes, the same analysis applies as for the commercial property. As the trustees pay tax at 40% on the income, the only real benefit arises if Lisa suffers a lower marginal rate on her share of the income, or if income is paid to the other beneficiaries and they have a lower marginal rate.

There should be no SDLT on the transfer as there is no consideration, either cash or in the form of assumption of debt.

It might be possible to improve the IHT position by selling the property to the trust and leaving the consideration outstanding on loan account. However, this would crystallise a capital gains tax charge at the point of transfer and would also result in an SDLT charge based on the full value of the property.

It would therefore not be our recommended course of action to place this particular property in the trust.

Inheritance Tax

Based on the information available in your letter, I have estimated the IHT charge on second death in Appendix III. Based on current asset values, the tax payable on second death would be in the region of £790,400.

I have assumed for the purposes of the calculation that there is no mortgage outstanding on your private residence. I have also assumed that there is no business property relief available on the commercial property.

You will see from the calculation that you have already used £150,000 of your nil rate band due to the gifts made to the children and into the trust. However, this is only the situation for seven years from the date of the gifts. Therefore by 2011 you will have your full nil rate band once again (unless you decide to make further gifts in the meantime).

In terms of the Will, it is important that you are able to find these documents as your executors will need them on death. However, we would recommend that your Will is properly reviewed in any event to reflect your current circumstances. For example, you would be well advised to ensure that you are able to use both nil rate bands on death, which might be achieved by setting up a discretionary trust within your Wills.

It is also worth you considering whether leaving the remaining estate to each other absolutely is still the most effective way to set up your Wills. It is possible to leave the remaining estate to each other on flexible life interest trust, which provides more flexibility after the first death and an element of protection of the capital going forward.

You may also want to consider at this time whether or not you would like to make any further gifts to your children or grandchildren absolutely. Any gifts you make in this way will be free of IHT providing you survive for a seven year period from the date of the gift. If you die within the seven years, the gift may become chargeable but after three years an element of taper relief is given to reduce the amount of tax payable.

I would suggest that we meet up with you shortly to discuss your Will and assist you in drafting a revised Will that will meet your current requirements.

Going Forward

I hope this letter clearly explains the tax implications of the transactions you are considering. You will see that as a result of the changes made in FA 2006, there are far more pitfalls now and A&M trusts are less "useful" than they have been historically. However, placing assets in trust for your grandchildren is still likely to be more appealing than giving them assets directly and you may therefore consider that you would still like to place assets into the trust going forward. The key is to ensure that the "right" assets are selected.

If you would like to discuss any of the points set out in this letter further, please feel free to give me a call.

Yours sincerely

T Adviser

Appendix I

	Amount	Lisa 1/3 share	A&M 2/3
Dividend (gross)	33,333	11,111	22,222
Bank interest (gross)	23,200	7,733	15,467
Rental property	150,000	50,000	100,000
Total income	206,533	68,844	137,689
Trust Management Expenses (TME) net	4,750	1,583	3,167

	Non savings income	Savings income	Dividend income
Rental income	150,000		
Interest		23,200	
Dividends			33,333
Total trust income	150,000	23,200	33,333
Less: 1/3 IIP	(50,000)	(7,733)	(11,111)
A&M income 2/3	100,000	15,467	22,222
Less: TMEs: £3,167 × 100/90			(3,518)
Income taxable at trust rates	100,000	15,467	18,704

Tax:	
SRB: £1,000 / 2 (as two related trusts):	
£500 @ 22%	110
£(99,500 + 15,467) @ 40%	45,987
£18,704 @ 32½%	6,079
Tax liability	52,176
Less: tax deducted at source	
Dividends: £18,704 @ 10% *(note 1)*	(1,870)
Interest *(note 2)*: £15,467 @ 20%	(3,093)
Tax due	47,213
IIP element	
£50,000 @ 22% *(note 3)*	11,000
Total tax due	**58,213**

Notes

(1) The dividend income used to pay the trust expenses is taxed at the basic rate (10%) and comes with a 10% tax credit. There is no further liability on this income.

(2) Credit will be given for candidates who assume the interest was received gross.

(3) The tax liability on the IIP element's savings income at 20% and dividend income at 10% is covered by tax credits of 20% and 10% respectively. There is no further liability on this income.

Appendix II

10 year charge

In order to calculate the exit charge it is necessary to calculate the ten yearly charge tax rate that would have been payable on 23 March 2000 if the trust assets had been relevant property at that point.

Notional 10 year charge

			£
Value of trust assets			3,300,000
Less: nil rate band		312,000	
Less: Settlor's cumulative total		(50,000)	
			(262,000)
			3,038,000
Tax at lifetime rate of 20%			607,600
Effective rate	607,600 / 3,300,000		18.41%
Actual rate 30%	18.41% x 30%		5.52%

Exit Charge

The distributions in December 2008 will result in an exit charge.

As the trust assets have only been relevant property since April 2008, this means by December 2008, it will have been relevant property and therefore chargeable for 9 months, i.e. 3 quarters.

Exit charge

Notional 10 year charge percentage		5.52%
Chargeable quarters as relevant property	April 2008 - Dec 2008	3/40
Exit charge percentage	5.52% x 3/40	0.41%
Tax payable on distributions	0.41% x £490,000	£2,009

Note. Candidates will receive full credit if they assume that the trustees pay the tax. The IHT in this case is 0.41%/ (100%- 0.41%) × £490,000 = £2,017.

Note. Candidates applying the FA2008 rules, ie that A&M trusts only enter the relevant property trust regime from 6 October 2008 (not 6 April 2008), will receive credit for explaining that there will be no exit charge as the distributions take place within the first quarter.

Appendix III

Estimated IHT liability on second death

	£
Private Residence	1,500,000
Bobbins Investments shares	500,000
Holiday Cottage	350,000
Commercial Property	350,000
Mortgage on commercial property	(300,000)
Cash	200,000
Chattels	50,000
Charitable donation	(200,000)
Balance of nil rate band (Mr)	(162,000)
Nil rate band (Mrs)	(312,000)
Chargeable estate	1,976,000
Tax at 40%	£790,400

Question 3

White Ltd Group

Briefing note for the tax partner prior to an initial meeting with the finance director of White Ltd.

This note is based upon the following information provided by the finance director of White Ltd:-

Exhibit A: The White Ltd group structure at 1 January 2007

Exhibit B: Information extracted from the draft tax computations of the group for the year ended 31 December 2007.

Exhibit C: Details of various group transactions and activities

1 **UK taxation consequences of various transactions**

1.1 **Transactions involving Red Ltd**

Sale of land from Red Ltd to Blue Ltd

Blue Ltd will acquire the land at market value for tax purposes. Exemption from SDLT will have correctly been claimed.

Issue off shares in Red Ltd to the members of Cerise Limited Liability Partnership

There will be no gains degrouping charge on Red Ltd leaving the White Group as the land was not acquired under the provisions of s171 TCGA 1992. Also the transferor and transferee were associated at the time of transfer and at the time when Red Ltd left the White Group.

An SDLT de-grouping charge will not arise as a consequence of the share issue by Red Ltd. When Red Ltd leaves the White Group there are no transfers to which these provisions apply. The only transfer on which a SDLT exemption was claimed was between Red Ltd and Blue Ltd which remain in a 75% group after the change in ownership in Red Ltd.

Payment by White Ltd under guarantee arrangement

At the time the debt was entered into, Blue Ltd was not a company connected with White Ltd for transfer pricing purposes (being only an indirect 40% shareholder) and accordingly the fact that a charge was not paid for granting this facility will not give rise to a tax adjustment.

The payment of £500,000 is not a loan relationship debit as monies paid as a guarantor do not arise from the lending of money. [s81(1) FA 1996] However, where the guarantor and the debtor are not connected and the loan cannot be recovered from the debtor ie it has been written off by White Ltd, the write off may possibly be treated as a loan relationship debit.

Losses incurred by Blue Ltd

Trading losses incurred by Blue Ltd for the year ended 31 December 2007 cannot be surrendered to the UK resident members of the White Group as only 40% of the shares of this company are held by corporations (a limited liability partnership is not a corporation for these purposes). Blue Ltd's losses could be surrendered to Red Ltd but as it has no available PCTCT it is unable to actually claim the losses.

Conclusion

The only material error in the taxation arrangements concerning these transactions is the incorrect consortium relief claimed in the draft 2007 tax computations.

1.2 **Transactions involving Green Ltd**

Development of commercial units – 2006

To determine the correct taxation treatment of the activities undertaken by this company it must be decided whether the activities represent trading or the simple holding and realisation of investments. This is an area of uncertainty when groups or companies hold property assets for a variety of motives (the holding of investments to derive rental income and capital appreciation or the active purchase and development of real estate with a view to a sale).

Trading activity "normally includes the exchange of goods and services for reward….there must be something which the trader offers to provide by way of business".

The question of whether a trade exists is one of fact. Over the years the Courts have shown due regard to the "badges of trade" as listed by the Royal Commission 1955. The badges are:-

(i) The subject matter of realisation
(ii) The length of period of ownership
(iii) The frequency of similar activities
(iv) Supplementary work on or in connection with the property realised
(v) The circumstances of realisation
(vi) The motive for the transaction

These badges have been refined by the decisions of the Courts and Commissioners including Rosemoore Investments v Inspector of Taxes. These included whether the transaction had a "one off" nature and whether the purchaser intended to resell the subject matter at the time of acquisition.

The development of the commercial units would clearly appear to be a trading transaction with a significant period of ownership of the land which had been held as trading stock and extensive work being undertaken to realise and dispose of the asset. The motive appears to have a clear trading bias.

Trading losses carried forward

As a consequence, losses derived from the development of the retail units should correctly fall to be treated as trading losses and relieved as appropriate under s393 ICTA 1988 et seq or the provisions regarding the surrender of losses as group relief s402 ICTA 1988 et seq.

In deciding whether the trading losses arising in 2006 are available for offset in future accounting periods, it will have to be decided whether in fact the trade of the company ceased when the commercial units had been developed.

If it could be shown that the trading activity had ceased the terminal loss provisions of s388 ICTA 1988 would need to be considered.

Debt write-off by White Ltd

As a connected party, loan relationship debits and credits arising from the loan between White Ltd and Green Ltd should be disregarded for corporation tax purposes and therefore no relief is due in respect of the £700,000 loan write-off as currently shown in the draft 2007 tax computations.

Acquisition of office building from White Ltd – January 2007

The office building held by White Ltd would appear, from the information provided, to be a capital asset held as an investment. From the draft 2007 tax computation White Ltd does not appear to undertake any trading activities.

Where one company transfers a capital asset to another company in a group and the recipient appropriates the asset to trading stock, legislation provides that allowing the disposal to be at a figure that results in neither a gain nor a loss is contrary to the principle that the asset should enter trading stock at market value. [s173 TCGA 1992]

Accordingly legislation is provided to the effect that the recipient company receives the asset as a capital asset at nil gain, nil loss but then immediately transfers it to trading stock at market value thus generating either a capital gain or an allowable loss. The recipient has the right to chose between an immediate capital gain and a later trading profit by virtue of the election available under s161(3) TCGA 1992.

When deciding whether a company has actually received an asset from another group company as trading stock or a capital asset it has been held that the circumstances as a whole must be considered to determine the motive for the realisation of the asset.

Accordingly the badges of trade must be considered in the light of the office block transaction.

- The office building was to be held for a limited period by Green Ltd.
- The post acquisition work on the property appears by Green Ltd to have been minimal and would appear to represent remedial work rather than supplementary work of a trading nature.
- The circumstances of realisation appear to be the simple desire for the group to realise a gain as a consequence of having vacant possession of the property.
- There is a general absence of badges of trade activity associated with the period of ownership of Green Ltd.

These issues combined with the fact that the trading operations of Green Ltd appear to have ceased leads to a serious concern that Green Ltd actually acquired the office building as a capital asset on a no gain/no loss basis under the provisions of s171 TCGA 1992 and that trading losses brought forward will not be allowable to set against the gain derived from the ultimate sale of the property.

Sale of shares in Green Ltd by White Ltd – June 2007

If the office building is considered to be a s171 TCGA 1992 transfer from White Ltd, the sale 30% of the shares of Green Ltd in June 2007 will be problematic. As a consequence of Green Ltd leaving the White Ltd group within six years of acquiring a capital asset from a group company, a de grouping charge under the provisions of s179 TCGA 1992 will arise. For further details regarding the operation of s179 TCGA 1992 see part 1.3 below regarding the transactions involving the sale of the shares in Cyan Ltd.

It seems unlikely that the sale of 30% of the shares in Green Ltd will fall to be treated as subject to the substantial shareholdings election due to the status of the company and the White Group. Further investigation could take place but from the information provided regarding the extent of the non-trading property interest of the group, the availability of the exemption seems remote. Details of the proceeds received for the shares and the date of acquisition will be required to confirm the estimated gain and the loss set off. It may then be considered whether any capital losses remain in White Ltd which could be subject to a s171A TCGA 1992 notional transfer

The transfer of the office building from White Ltd to Green Ltd in 2006 will have been subject to exemption from Stamp Duty Land Tax under the group relief provision.

As a consequence of the sale of 30% of shares in Green Ltd, the company will leave the stamp duty group and a charge to SDLT will arise (as within three years of the date of the original transfer).

Sale of office building by Green Ltd – December 2007

A capital gain of £2,000,000 less indexation will arise of the sale of the office building for £6,100,000. The nature of the condition to the contract should be investigated to determine if the disposal actually arises for capital gains purposes in 2007 or 2008.

Conclusion

Trading losses brought forward are unlikely to be available to set against profits arising from the ultimate sale of the building and the potential s179 TCGA 1992 charge means that there is probably a substantial underpayment of UK corporation tax. See section 3 below for details of the revised corporation tax computations of the White Group.

1.3 **Disposal of shares in Cyan Ltd**

Sale of investment property from Gold Ltd – 2006

The sale of the investment property from Gold Ltd, as a transfer between members of the White Ltd capital gains group (75% ownership test) will take place under the provisions of s171 TCGA 1992 at such a value which gives rise to neither a gain nor a loss. Effectively the actual consideration paid will be ignored and qualifying cost plus indexation allowance will be substituted.

SDLT group exemption has been correctly claimed in respect of this transfer.

Payment of dividend to White Ltd

The receipt of a dividend from a UK resident company is not subject to corporation tax.

Sale of shares in Cyan Ltd – September 2007

If a company leaves a capital gains tax group and it then holds a chargeable asset which it has acquired from another group company within the previous six years the departing group company is treated as having disposed of the asset and reacquired it at market value at the time of the intra group acquisition.

However a charge does not arise if the company had received a chargeable asset from an associated company within the previous six years and the transferor and transferee leave the CGT group at the same time. To be associated for this purpose the transferor and transferee must form a sub-group in their own right. [s179(2) TCGA 1992]

It could therefore be argued that Cyan Ltd and Gold Ltd leave the group at the same time and as a consequence a charge relating to the property transfer does not arise (there would be a potential charge in respect of the shares of Gold Ltd acquired by Cyan Ltd but this asset has no value).

This interpretation of the operation of s179 TCGA 1992 has been clarified by the Special Commissioners' case – Johnson Publishing – in 2006 where it was held that not only did the companies need to be associated for this purpose at the time the companies left the group but also at the time the original transfer was made. This is not the case in respect of these transactions and accordingly an exit charge will arise.

Conclusion

A significant s179 TCGA 1992 gain will arise as a consequence of this transaction with limited capital losses being available to the group - £600,000 in White Ltd (see revised 2007 computations in section 3 below).

A capital gain (after indexation relief) will also arise on the sale of the shares in Cyan Ltd. This gain should be reduced to nil by agreed capital losses brought forward in White Ltd. Further information is required (see section 2 below).

1.4 **Yellow Ltd**

Payment of interest to non-resident company

If interest due on the loans between Yellow Ltd and the UK resident members of the White Group represent annual interest (rather than the payment of short interest or discount), income tax at the basic rate should have been accounted for in respect of these payments by the payer.

It is unclear from the information provided what the exact status of the interest due is and the consequential effect of this provision.

In the absence of any detailed tax advice being obtained as part of these transactions it is likely that the payments will represent simple annual interest on which overdue income tax and interest is due.

Loan to White Ltd from UK bank

There must be concern whether interest paid in respect of this loan will be allowable under the loan relationship rules. It could be contended that the loan has been used in an attempt to generate offshore income not subject to UK corporation tax. The loan may fall to be treated as a loan for unallowable purposes under the provisions of Para 13 Sch 9 FA1996. Guidance as to the meaning of loans for unallowable purposes was given in the recent Prudential Special Commissioner case regarding “out of the money swaps”.

Payments to a landlord resident outside the UK

Net rental income of a non-resident landlord derived from land in the UK is subject the payment of income tax at the rate of 22%. From the draft computations for 2007 it would appear that this liability has not been made.

Controlled foreign companies legislation

As a 100% owned subsidiary resident in a low tax jurisdiction it seems likely that the non-property income of the company will be subject to the UK rules regarding controlled foreign companies.

The various exemptions against these provisions do not seem to apply:

(i) exempt activities test

(ii) motive test

(iii) de-minimis activities test

(iv) public quotation test

(v) excluded territories exemptions

Accordingly the CFC status of Yellow Ltd should be disclosed in the UK corporation tax return of White Ltd. A UK tax liability would not arise on profits of Yellow Ltd apportioned to White Ltd if any acceptable distribution policy has been pursued by the company. This information has not been provided by the finance director of White Ltd.

Change of residence status/future losses

Under UK rules, if the central management and control of a company is exercised from the UK, that company will be considered to be resident in the UK for corporation tax purposes. It would appear that Yellow Ltd will continue to be treated as resident in Gulderney by virtue of being incorporated there.

As a consequence the company would be considered to be a dually resident company. Yellow Ltd appears to hold no assets other than property and financial investments. As a consequence the company will be treated as a dual resident investment holding company.

Various restrictions are applied to such companies, one of which is that losses cannot be surrendered by such a company to UK resident members of the group. As a consequence any deficits arising in Yellow Ltd in subsequent accounting periods will not be relieved against the UK source income and gains of the group.

Proposed transfer of assets from UK companies to Yellow Ltd

Transfers of chargeable assets from UK resident members of a group to a dual resident investment company are not subject to the no gain no loss group provisions and accordingly market value should be applied to such transactions.

A significant gain will arise on the transfer of investment property assets from UK members of the group to Yellow Ltd

Conclusion

There appear to be significant unpaid UK tax liabilities in respect of Yellow Ltd and the proposed reorganisation and refinancing of the White Group would appear to have significant UK tax disadvantages.

2 **Additional information required to complete the analysis of the UK taxation of these transactions**.

2.1 **Transactions involving Green Ltd**

Any information supporting the argument that the company continued trading operations after 2006.

Any evidence to support the contention that the sale of the office building represented a trading transaction.

Further examination of the status of White Ltd to confirm that it is not a trading company or holding company of a trading group and accordingly that the substantial shareholdings exemption does not apply.

Details of the conditional nature of the contract for sale of the office building to determine when this gain is properly taxable.

Details of the proceeds from the sale of the 30% of the shares in this company will be required to accurately calculate the gain arising and any surplus capital losses available in White Ltd.

2.2 **Sale of shares in Cyan Ltd**

Details of the exact date of the acquisition of the shares in this company are required to accurately calculate the capital gain and loss offset arising.

2.3 **Arrangements involving Yellow Ltd**

Details of interest payments received from UK members of the White Group to determine whether income tax should have been deducted from these payments or a copy of any HMRC agreement to make payments of interest gross.

Details of any dividend payments made or proposed by Yellow Ltd to determine if any such dividends meet an acceptable distribution policy.

Confirmation that Yellow Ltd will remain resident under Gulderney tax rules when central management and control of the company moves to the UK.

2.4 **Taxation computations for 2006**

Details of interest income of Yellow Ltd arising from UK members of the White Ltd group in order to ascertain exposure to UK income tax and CFC charges for the year.

3 **Recommended actions which should now be taken by the group to mitigate or reduce any UK tax liabilities, interest charges or penalties**

Revised corporation tax computations for the year ended 31 December 2007

A substantial payment should be made for the year to 31 December 2007 in line with the revised tax computations.

2006 CTSA return for White Ltd should be revised to disclose CFC issue regarding Yellow Ltd.

Disclosure of prior year liabilities regarding non-resident landlord activities of Yellow Ltd.

Refinancing arrangements to be reconsidered, using UK resident company to avoid group relief restrictions.

Intra-group transfers of investment properties standing at significant capital gains to Yellow Ltd to be reconsidered.

Payment of SDLT de-grouping charge in respect of Green Ltd/Cyan Ltd.

Question 4

Report for Finance Director

Report for:	Andy Flood - Finance Director
Prepared by:	Simon Gale - Taxation Manager
Subject:	Green Taxes
Date:	14 May 2008

This report has been prepared in response to your e-mail of 15 April 2008.

1) Green Taxes

Introduction

I would define a green tax as one that aims to change a person's or organisation's behaviour and persuades them to reduce their impact on the environment. Such a tax also punishes polluters.

The indirect taxes that are relevant to this discussion for FRX are Climate Change Levy, Landfill Tax, Aggregates Levy and Value Added Tax. I will also look briefly at direct tax issues arising on capital expenditure. Below, as requested, I have shown a brief resume of each tax, together with an assessment of whether the tax achieves the aim of having the necessary impact on the environment, and where FRX may be able to benefit from green incentives:

Climate Change Levy (CCL)

CCL is a tax with environmental objectives that was introduced on 1 April 2001 as part of the UK's Climate Change Programme. It is charged on the end-use of taxable commodities (principally electricity, gas and coal) by commercial customers. It does not apply to domestic households, or charitable customers acting in a non-business capacity.

CCL is charged on the amount of commodity supplied rather than its value (as would be the case for VAT). The rates of CCL vary according to the commodity. Electricity at 0.441p per kwh, for example, has a higher rate of levy than gas (at 0.154p per kwh), because of the losses in transmission from supplier to user. Measuring consumption at the meter is not a fair reflection of the environmental harm done by the heat generated. The levy on coal is charged at £1.201 per kwh.

The levy is a single stage non-deductible tax, which only affects the end-user. It does not apply along the production chain, of say, producer to wholesaler. VAT is charged at 17.5% on the CCL inclusive price of the commodity.

Reduction in carbon emissions

There are a number of exemptions within the legislation, as well as Climate Change Levy Agreements, which can influence behaviour and lead to reduced emissions.

The exemptions from CCL (Sch 6 FA 2000), which can influence behaviour are as follows:

- electricity produced by own resources (called auto-generators) (refer para. 17);
- electricity used in the recycling processes (para. 18A);
- electricity from renewable resources (para. 19);
- electricity produced in combined heat and power stations (CHPs).

I shall discuss CHPs separately in the next section of this report.

A producer is known as an auto-generator where electricity is generated primarily for own use, where the owner of the generating plant has title to the input and output fuel. (Primarily for own use means at least 75% of the generated output). Relief from the levy is obtained via a certification process. For many businesses, auto-generation has some potential, although most of the wind turbines on top of buildings do not support the initial cost. The decision to install a wind turbine may be taken for political reasons rather than to achieve genuine power savings.

There is an exemption from the levy if the person to whom the supply of an energy product is made intends to use it in a prescribed recycling process, and therefore otherwise than as fuel. The exemption only applies where the recycling process is less energy intensive and liable to higher CCL charges per tonne of output than the primary process, and the objective of the recycling process must be to produce the same output as the primary process.

There is also an exemption from the levy for trying to source electricity from alternative renewable sources of energy that do not produce carbon emissions. Renewable sources refer to sources other than fossil fuel, but specifically exclude nuclear fuel. Such sources include wind energy, small scale hydro-electric power, tidal power, wave energy, geothermal hot dry rock, geothermal aquifers, municipal and industrial wastes, landfill gas, coal mine methane, agriculture and forestry wastes and energy crops.

The use of Climate Change Levy Agreements (CCLAs) may also influence behaviour. High energy users are able to enter into agreements with the government – they can receive taxable commodities at 20% of the normal CCL rate for the period of the agreement, on the basis that they will use the saved money to invest in more energy efficient equipment which will be kinder to the environment and therefore meet carbon saving reduction targets. (para. 47 Sch 6 FA 2000)

The overall responsibility for an agreement lies with the Department for Environment Food and Rural Affairs (DEFRA) and the Secretary of State. The role of HM Revenue & Customs is to oversee the application of the reduced-rate and not other aspects of agreements.

An energy intensive installation is a site that is covered by the Pollution Prevention and Control (England and Wales) Regulations 2000 (SI 2000/1973). If an energy intensive installation consumes more than 90% of the total for each taxable commodity used on the site, then the entire site is eligible to be covered by a climate change levy agreement (CCLA). Otherwise, the facility needs to be defined such that at least 90% of the taxable commodities passing through the meters are used within the energy intensive installation.

This energy is then eligible to be covered by the climate change levy agreement (CCLA).

CCLAs

When CCL was first introduced in 2001, a reduced rate of 50% of the levy was charged on supplies to eligible horticultural producers for a temporary period of five years. In 2006, at the end of the five year period, HM Revenue & Customs invited horticultural producers to sign CCLAs in order to receive the 20% reduced rate in return for meeting specific energy efficiency targets. (BN 52 / 2006)

Landfill Tax (LFT)

LFT was introduced in October 1996 and is a tax on the disposal of waste at licensed landfill sites. It acts as a typical indirect tax; tax is levied on the amount tipped. LFT is levied at two rates - £2 per tonne for inactive waste (such as bricks) and £24 a tonne for active waste (such as food waste and grass clippings). (The budget proposals are for these rates to increase from 1 April 2008 to £2.50 per tonne and £32 per tonne respectively).

Tax has to be accounted for by the landfill site operators, who pass the tax onto the customers. It is the licence holder for the landfill site that has to register for LFT, or failing that person, the controller of the site. The LFT inclusive price of the disposal is then increased by 17.5% for VAT. LFT charged will be a cost to FRX, although we will be able to recover the VAT charged, having been incurred in the course or furtherance of our business.

Reduction in carbon emissions

Landfill Tax is a tax on the disposal of waste. It aims to encourage waste producers to produce less waste and to recover more value from waste, for example through recycling or composting. It also aims to promote more environmentally friendly methods of waste disposal.

As noted above, there are two rates of LFT for active and inactive waste. Active waste generates greenhouse gases, particularly methane, when it decomposes, so this accounts for the large difference between the two rates of the tax. Clearly the high rate of tax for active waste is a disincentive to tip such waste. It is likely that the incidence of LFT has changed behaviour since its introduction and has encouraged recycling. Meanwhile, as you note, the rates for LFT continue to rise.

Exemptions from LFT exist. The two most relevant to our business are exemptions relating to quarrying:

Waste arising from mining and quarrying operations and disposed of to landfill is exempt from landfill tax (s 44 FA 1996), provided that:

- the material results from commercial mining or quarrying operations,
- the material has the same chemical composition as it had when it was in the ground; and
- the material is not be produced from a process separate from the mining/quarrying operation.

There is exemption also for filling existing or former quarries with inactive waste, under the relevant conditions (s 44A FA 1996). Essentially the quarry or former quarry must be wholly or partially refilled in accordance with planning consent.

Other exemptions from the tax, encouraging lower emissions, are as follows:

Waste arising from the clearance of contaminated land and disposed of to landfill may qualify for exemption. This is a necessary element of bringing Brownfield sites back into use. To qualify for the exemption, waste must come from the reclamation of land that has been contaminated by past industrial or other activity, and meets certain other conditions. (s 43A FA 1996)

Inactive (or inert) waste which is used for the purposes of restoring to use a landfill site or part of a landfill site may qualify for exemption. Restoration means any work, other than the capping of the waste, for which authorisation has been obtained, in order to restore the site to use (s 43C FA 1996).

In addition to exemptions, there are also tax credits to encourage environmental benefits.

The Landfill Communities Fund (formerly the Landfill Tax Credit Scheme) enables landfill site operators to claim a tax credit for contributions they make to approved environmental bodies for spending on projects that benefit the environment, such as encouraging bio diversity in local ponds. The environmental bodies are those enrolled by ENTRUST, the regulatory body for the scheme. (s 53 FA 1996).

There is also a credit for waste removed for recycling, incineration or re-use. Credit may be claimed where waste has been landfilled temporarily and the taxpayer gave advance notice of this intention to HM Revenue & Customs and the waste is removed within a specified period from the date of disposal, usually 12 months. (Regulation 21 SI 1996/1527)

Aggregates Levy (AL)

AL was introduced in 2002 and is a charge on the commercial exploitation of taxable aggregate. The levy falls principally on quarry operators, who will on-charge the levy to customers. The rate of levy is £1.60 per tonne, pro-rated for part tonnes.

AL is, like LFT, a single stage indirect tax, based on the polluter pays principal, with the amount of levy charged dependent on the amount of quarrying activity. VAT is charged on top of the price inclusive of the levy.

Under the heading of commercial exploitation, in-quarry operations and sales within quarries will be charged to AL, even if the aggregate hasn't left the premises. This is on the grounds that the environmental damage has been done. (s 19 FA 2001)

Reduction in carbon emissions

AL is based on the simple principle that the polluter pays. There are a few exemptions and a series of credits.

The most important credit arises for use in some prescribed industrial and agricultural processes. These are processes for which the legislation permits relief, for example, iron and steel manufacture, where, say, sand is used for casting. (s 30(1)(c) FA 2001)

In order to decide whether something is a prescribed process or not, one fundamental question has to be addressed: is the material under consideration being used as an aggregate or not? Thus limestone ground down to a fine powder to act as a 'glue' or binding medium will be relieved from the levy because it is used as a non-aggregate.

There is also a credit where aggregate is exported from the UK. This export credit does not appear to assist with protecting the environment, as the pollution has already occurred in the UK. (s 30(1)(a) FA 2001)

VAT

When the above single stage taxes are levied, VAT at 17.5% will have to be charged over and above that tax when a taxable supply is made by a taxable person. Thus a landfill site operator will need to account for output tax at 17.5% calculated on the LFT inclusive amount for the landfill disposal. The principal difference between VAT and green taxes is that the green tax is not recoverable whereas VAT, as a multi stage tax, will be recoverable in the hands of a fully taxable trader such as ourselves. Therefore VAT does not necessarily have the impact of a green tax in reducing emissions.

In order to encourage the reduction of carbon emissions, there are provisions within the VAT Act 1994 (at Schedule 7A) to apply the 5% reduced rate of VAT to the installation of various energy saving materials and the installation of renewable source heating systems in residential accommodation.

Capital Expenditure

Enhanced capital allowances at 100% are available for certain energy efficient plant and machinery, for example certain boilers. HM Revenue & Customs maintain a list of specific items of plant and machinery qualifying for the enhanced allowances and therefore when considering capital expenditure, we should always consider whether there is an approved alternative product which would gain the more attractive capital allowances than normal.

For company cars, there are again enhanced allowances for the most fuel efficient cars. In a similar vein, the class 1A national insurance which we pay on company cars is directly related to the fuel efficiency of the cars (as represented by their CO2 emissions rating). By switching our fleet to more efficient cars we should again be able to make savings (both of tax and absolute savings through the reduction in the company fuel bill).

Employees also suffer a lower income tax bill on the benefit in kind of lower CO2 rated cars, adding to the incentive to use less polluting vehicles.

Emissions trading scheme – tax implications

VAT

The transfer of entitlement to use carbon emission allowances (quotas) between companies in the UK will be a taxable supply of services if the supply is made for a consideration. UK VAT will have to be charged and invoiced to the customer.

Defra will initially allocate emission allowances to UK companies. These are generally freely given and not for a consideration. Consequently the allocation is outside the scope of VAT.

At the end of a given period, allowances will be surrendered by users to the authorities for the actual carbon emissions. This is done to fulfil a legal obligation and is done for no consideration. Thus the surrender of allowances is also outside the scope of VAT.

HM Revenue & Customs has issued VAT policy in respect of the supply of trading allowances in greenhouse gas emissions. The policy is included in Revenue & Customs Brief 52/07 and came into force on 22 August 2007.

The place of supply of cross border trading in emissions instruments is the place where the recipient belongs. In other words the reverse charge mechanism applies to such instruments.

Direct taxes

In addition to the indirect tax consequences, the trading of emissions quotas will also have direct tax consequences. At first sight, the quotas might be regarded as capital assets subject to corporation tax on chargeable gains on sale. However, I am aware that intangible assets in general for companies are dealt with under a special intangible asset regime which follows the accounting policy and treats expenditure and income as part of the trading result rather than as chargeable gains..

Given however that we will generally be acquiring quotas for relatively short term use, I would expect expenses relating to them to simply be matched with our usage of them as a trading deduction. It may be appropriate to take further direct tax specialist advice in this regard.

(Credit will be given for all relevant matters discussed)

2) **Combined Heat & Power Station**

Combined heat and power stations are basically electricity generators, which not only sell the power, but also make use of the enormous quantities of heat which are generated with the electricity. Heat does not travel, so using it locally (either within the plant or nearby buildings), is environmentally beneficial. Further, the burning of waste to generate electricity saves waste going to landfill. Consequently, power output from a CHP is exempted from CCL, either partly or in full.

The energy efficiency and environmental performance of CHP schemes allows them to be put into one of a number of categories. Calculations are performed to determine the CCL treatment of taxable commodities supplied to the station, and also the treatment of electricity produced in the station. Thus for a CHP station there is a possibility of exemption from CCL both for fuel inputs to the station and also for the outputs.

Inputs

Ideally, FRX will wish to receive full exemption from CCL for all energy inputs into the CHP station. Whether this may be achieved depends on calculations under the CHP Quality Assurance programme, which is administered on behalf of the Department for Environment, Food and Rural Affairs (Defra) by The Office of Gas & Electricity Markets (Ofgem). Assuming that the relevant criteria are met, Ofgem will issue the appropriate Levy Exemption Certificates to cover each qualifying Megawatt hour (MWh) of electricity, in order that CCL will not fall due.

To determine the amount of CCL exemption for input taxable commodities used to produce outputs, the station must analyse its power efficiency compared with a threshold power efficiency as laid down by the Quality Assurance standard. The CCL exemption is scaled back by reference to the above fraction to recognise the reduced environmental benefit. The CHP station performs a self assessment and provides its energy supplier with a certificate to claim the appropriate amount of CCL exemption.

The CHP operator will need to review this supplier certificate and reconcile the amount of relief claimed on taxable commodities used as fuel inputs against the actual performance of the station over the same period. When such a review identifies differences between actual relief entitlement and amount of relief claimed in a review period, action must be taken as follows:

1. where the amount of relief claimed is found to be too high, resulting in an underpayment of levy, the excess is treated as being a deemed taxable self-supply and the CHP operator will need to notify a liability to register;
2. where the relief claimed is found to be too low resulting in an overpayment of levy, a claim for tax credit must be made.

Outputs

The CHP operator will also wish to maximise its CCL exemption for power outputs. I note that indirect supplies, i.e.supplies to licensed suppliers who make onward sales of the electricity, are being made. All electricity supplied in this manner is outside the scope of CCL and therefore the levy will not be charged. CCL should only be borne by the final consumer.

In respect of direct supplies to end customers and self supplies of output, CCL will need to be charged to the extent that the CHP operator does not achieve the qualifying criteria. The exemption from the levy charged is based on the fraction of Qualifying Power Output (QPO) to the total power output of the station. The QPO relates to the efficiency of the station in producing electricity. When heat demand falls in the summer, a CHP scheme with no heat rejection facility must regulate its output and finally shut down. In these circumstances, no heat can be supplied beyond the site demand, and the station's efficiency is impaired.

As for inputs of energy products, the CHP operator needs to perform an annual reconciliation of the actual performance of the station to the estimates that are produced for the purpose of claiming the levy exemption certificates. An adjustment for the under or over issue of exemption certificates then follows:

1 Ofgem will either issue further levy exemptions certificates, showing a current date of issue, where it is determined that a shortfall occurred; or

2 where an over issue is apparent, withhold the issue of any further certificates until the station has generated enough qualifying electricity to make good the deficit.

This restriction means that certificates will still be valid in the hands of electricity utilities, but the CHP operator may suffer a penalty for any deficit in the output record.

Registration

If FRX does not satisfy the exemption criteria for outputs, it will be liable to account for CCL on taxable supplies of outputs, either to end customers or self supplies. It may also make deemed taxable self-supplies as discussed above under the heading of inputs. If this is the case, FRX would therefore need to notify HM Revenue & Customs accordingly as soon as possible and register for Climate Change Levy. Unlike VAT, there is no registration threshold.

Penalties

Failure to notify the requirement to register at the correct time triggers a penalty of 5% of the relevant levy or £250, whichever is the greater. (The amount of levy due is calculated from the date on which the requirement to be registered arose to the date when HM Revenue & Customs are notified). Further, there will be a penalty of £250 for each MWh for which there is a deficit of valid certificates in relation to the total quantity of qualifying electricity generated.

These penalties may be waived however, if the supplier can satisfy HM Revenue & Customs or a Tribunal that there is a reasonable excuse for each of the failures.

Please let me know if you wish to discuss these matters further. I look forward to hearing from you.

Regards

Simon

Simon Gale

Taxation Manager

Question 5

Part 1

INTERNAL MEMORANDUM

Orange & Co

To: James White
From: Steve Blue
CC:
Date: 15 May 2008
Re: Various
Client: Marketing Magnificent Six (MMS)

Dear James

Thank you for your memo of 13 May 2008. In response:

Environmental Improvement Works - Centre Place Project

ERDF Grant

The receipt of the £400,000 grant from ERDF should be outside the scope of VAT. The fact that there may be conditions attaching to the use of the grant and a requirement that it is matched by funding from other sources will not detract from its outside the scope treatment. It is not consideration for a supply, nor a subsidy linked to the price of supplies, but rather a general subsidy supporting the activities of the entity receiving it (see Office des Produits Wallons ASBL v Belgium, CJEC Case C-184/00).

Matched Funding

Grants or Supplies?

The initial consideration is whether it would be preferable to argue that the amounts to be received should be subject to VAT or not. If VAT can be passed on to the other parties and they are able to recover it, then this would enable MMS to recover VAT on its costs. Clearly, there is an issue with Seaford Waterways Management Co Ltd (SWMC) as it is not VAT registered and so would be looking at a VAT inclusive amount as its contribution.

The main issue with regard to whether or not there is a supply is whether "something is being done in return for a consideration." The term "in return for" is important because there must be a direct link between the supply and the consideration. (See *C & E Commrs v The Apple & Pear Development Council HL [1988] STC 221* and *Tolsma CJEC case C-16/03* cases).

In respect of those parties that do not own land, it is difficult to see that they are deriving any direct benefit from the amounts that they are contributing. Consequently, it is likely that the sums paid by such parties, which seems to total £100,000, would be seen as grants or donations and outside the scope of VAT. A check needs to be made for each of the parties however to ensure that they do not fall within the interpretation set out below.

Contributions from Land Owners

There is likely to be a distinction of treatment with regard to Seaford City Council (SCC), SWMC and Westworld Conference Centre (WCC), on the basis that these parties are likely to own the land on which the works are to be carried out. In these cases, MMS would be undertaking improvement works to their land (e.g. street lighting, improvements etc) and receiving a "grant / donation" in return for doing so. Accordingly, there is a strong argument that there is a direct link between the tangible benefits or supplies received by the parties and the amounts they are paying to MMS (see Midland Bank case). In such circumstances the sums should be subject to VAT. In essence, the position would be no different from that of SCC etc going out and contracting for the works.

Consequently, it is considered that where sums are paid by parties owning land on which works are to be undertaken, those will be subject to VAT.

Recovery by Land Owners of VAT incurred

Local authorities are known as Section 33 Bodies for VAT purposes which enable them to recover VAT in respect of their "non business" activities under Section 33 VAT Act 1994. The main issues that need to be established in this regard are:

- Does SCC have an interest (i.e. ownership) in the land on which the works are to undertaken?
- If it went out and contracted for these works would they be able to recover the VAT under S33?

The main issue appears to be in what capacity the local authority would be doing the work and whether it is regarded as acting as a Highways Agency. My view would be that this would be recoverable under S33 VAT Act 1994 on the basis that it would be a non business activity, but this is a point that SCC will need to confirm.

SWMC is unable to recover any VAT incurred as it is not VAT registered. Accordingly, this will be an additional cost to SWMC.

The VAT recovery of WCC will be dependent upon the extent of the taxable supplies made by WCC. Given that this is a conference centre, it is quite likely that WCC has elected to charge VAT on the supplies of conference space in order to recover VAT incurred on the property. If for some reason the option to tax has not been exercised there would be a restriction of the VAT incurred.

Value of Supply

There is a possible argument to suggest that the supply to SCC and the other landowners should be for the full value of the works undertaken on its land rather than simply the amounts that they are contributing. The argument here would be that the ERDF grant is subsidising the supply being made by MMS to SCC and the others by providing third party consideration for the supply to be made to them. In such circumstances MMS would invoice the landowners for the full cost of the works to its land with VAT.

The position would be similar in respect of the donations received from the other various parties. Whilst these are outside the scope donations as far as the person paying is concerned, they could still be included in the value of the supply being made to the landowner. It depends on the extent of the linkage between the "donations" made and the supplies to which they relate. If the donations are made conditional on the supplies being carried out, there would be a reasonably strong case for treating the donations as taxable income.

Matched Funding by MMS

The contribution made by MMS is in kind as opposed to cash (i.e. it will use its staff and other assets to a value of £50,000). This is not consideration for a separate supply, and any VAT incurred on costs (e.g. general overheads) will be attributable to the main supplies made by MMS (i.e. the charges made to the landowners).

The profit of £75,000 retained by MMS is also not consideration for a separate supply but just part of the £1 million plus VAT charged to the landowners.

VAT Recovery by MMS

Assuming that all of the works to be undertaken are on land owned by the landowners (i.e. there are no works on land where the owner is not contributing), MMS should be able to fully recover VAT incurred on the works on the basis that it is making taxable supplies to the landowners.

If there are works on pieces of land where the landowner is not making a contribution, there is a danger that HM Revenue & Customs will seek to apportion VAT incurred by MMS between the VATable supply to the contributing landowners and the non-business supplies to the non-contributing landowners.

Summary and Recommended Action

1 Confirm the position regarding the ownership of the land on which the works are to be undertaken;

2 Where these parties are paying amounts, it is likely that there is a supply by MMS which would be subject to VAT;

3 The contracts should be VAT exclusive wherever possible;

4 Confirm that SCC can recover input tax under S33 VAT Act 1994 (i.e. what would the position be if it simply went out and undertook the works itself?);

5 Confirm that the other parties owning land are able to recover VAT incurred. (WCC should be able to; but SWMC will not be able to).

6 Treat the amounts received from land owning organisations as subject to VAT. The value of the supply might be the total amount received from all sources (i.e. including the amounts paid by third parties), but it is strongly arguable that the donations are not linked to supplies and should therefore not be taxable consideration.

7 In the event that SCC is not the owner of the land, need to establish which party is and whether it is paying any sums or could be seen to be. If the interpretation is that grants are being received from certain parties and other parties own the land (i.e. there is a mismatch), there is likely to be a restriction of VAT incurred which will need to be built into the calculations.

PART 2

Orange & Co
Chartered Accountants
27 Whitlock St
Seaford SK7 4FG

20 May 2008

Our Ref SM/JC

C Blonde

Finance Director
Marketing Magnificent Six Ltd
Calvera House
Webster Road
Seaford SK6 8YG

Dear Charles

DISPOSAL OF CALVERA HOUSE AND WASters PROJECT

Thank you for your email of 14 May 2008. In response to this and your previous meeting with James White, I can respond as follows:

Disposal of Calvera House

From the information provided in your email, I calculate the corporation tax position on the chargeable gain as follows:

	£	£
Proceeds – June 2008		2,500,000
Less Disposal costs		15,000
		2,485,000
Less Cost & Enhancement		
June 1977	250,000	
December 1994	500,000	750,000
Unindexed Gain		1,735,000
Indexation Allowance		
On cost		
March 1982 - June 2008		
March 1982		
$\frac{214.3-79.44}{79.44}$		
= 1.698 x Cost	250,000	424,500
On enhancement		
December 1994 - June 2008		
December 1994		
$\frac{214.3-146}{146}$		
= 0.468 x Enhancement Value	500,000	234,000
Gain		1,076,500
Rollover Relief		
Proceeds		2,485,000
Cost reinvested		2,030,000
Gain not reinvested		455,000
Total cost of new asset		2,030,000
Gain reinvested	1,076,500 - 455,000	621,500
Base cost of new asset		£1,408,500
Chargeable Gain		£455,000

You will note that I have used the original cost of the asset rather than the March 1982 value. The general rule is that the March 1982 value is used, but does not have to be in various circumstances, including where the effect of rebasing would be to increase the gain.

It is possible to make a rebasing election to substitute the March 1982 value for the original cost. Such an election, once made, is irrevocable and applies to all assets held at both 31 March 1982 and 5 April 1988. It must be made within two years of the end of the accounting period in first the first relevant disposal (i.e. the first disposal to which the 31 March 1982 rebasing rules apply) took place. Given however that the original cost in this case was higher than the March 1982 value, such an election should not be made for this disposal.

If it transpires that an election has been made in the past, it is irrevocable and applies to all affected disposals. The allowable cost would be lower by £50,000, so the chargeable gain would be increased by £50,000 plus the indexation on it at 1.698, reducing the base cost of the new asset by £134,900. The company's records should be examined to see if the election has been made.

WASters Project

The principal VAT issue is whether MMS would be obliged to account for the convention under the Tour Operators Margin Scheme (TOMS) or under normal VAT accounting principles. This will then determine the recoverability of VAT incurred and the need (possibly) to charge VAT onto Brad Pink Inc.

The VAT liability of the sponsorship income also needs to be considered.

Tour Operators Margin Scheme

This is a fairly complex area of VAT but in summary operates as follows:

1 Tour operators do not account for VAT on their income but rather on the margin between their selling price and the VAT inclusive cost of the supplies (transport, accommodation etc) that they have bought in for resale. Accordingly, they are not able to recover VAT incurred on such supplies;

2 Rather than being required to register for VAT in various members states, the tour operator is deemed to make supplies from where he is established, which in this case would be the UK;

3 Use of the tour operators margin scheme is compulsory if you fall within the scope of it, though there are certain exclusions (see below);

4 The definition of a tour operator is not limited to those that one would normally expect but can include any business that is undertaking the activity including organisers of school trips;

5 Excluded from the scheme are supplies to other business customers (though if the supplies are to be consumed by that business customer, rather than supplied on in the same state, they will fall under the scheme). It is however possible for tour operators supplying to business customers to choose to fall under the scheme (having sought permission from HM Revenue & Customs).

In the event that you are within the TOMS, MMS would not be able to recover any VAT on costs incurred that are to be resold, and would make an inclusive charge to WAS. Assuming that you are unable to uplift the contract price to reflect VAT that you are suffering (which is most likely to be the case), MMS would incur this VAT as a cost, and it could potentially turn the project into a loss making one depending upon the amount involved. If you do make a surplus (or margin) on the project, you would be liable to account for VAT on this under the TOMS.

I consider it important to assess the position by calculating the outcome under the TOMS and under "normal accounting". This will then allow us to consider the most beneficial route and whether or not we would want to be excluded from TOMS.

Supplies to business customers for subsequent onward sale are outside of the TOMS. In this regard, we must consider the position of Brad Pink Inc. It is clear from the Heads of Terms that Brad Pink Inc will be invoiced for the supplies and will pass these onto WAS. Consequently, even though Brad Pink Inc is described as "the Agent", it seems to be acting as a wholesaler. Accordingly, there appears to be scope for the transactions to be seen as outside of the TOMS.

If you fall outside of TOMS then there will be some supplies which will be subject to VAT, eg the accommodation and the supply of conference facilities, and the VAT incurred will be recoverable as input tax. It will therefore be necessary to consider the supplies made and determine which are subject to VAT in the UK.

Where VAT is chargeable, it is unlikely Brad Pink Inc would be able to reclaim much of this under the 13th Directive (which is a mechanism which allows non EU businesses to recover VAT incurred). Under the 13th Directive rules VAT incurred on goods and services, such as hotel accommodation, which have been bought in for resale and which are for the direct benefit of travellers, is specifically non claimable.

As set out in Business Brief 01/06 HM Revenue & Customs now accepts that ‘the provision of conference/function room hire, meals and sleeping accommodation under the 24 hour delegate rate (i.e. where the delegate is also provided with sleeping accommodation), even where made in return for an inclusive charge, should be treated as separate supplies. These will be taxable supplies, with the exception of the conference/function room hire, which will be an exempt supply, unless the hotel (i.e. WCC) has opted to tax its supplies. This needs to be checked, but it is common for such operators to opt to tax and it is therefore likely that all of these supplies will be subject to VAT.

In the event that MMS is seen to be dealing with WAS directly, then consideration must be given as to whether WAS is acting in a business capacity. In such circumstances we need to try to confirm (if possible), that WAS is charging its members for the convention, and in this regard, we should satisfy the business supplier test.

Given that there is the option for persons supplying business customers to be able to account under TOMS (with permission) we need to determine the most advantageous route. In this regard I should be grateful if you could provide me with a copy of the budget for the costs and the income and we can then determine the most advantageous route.

Note - It seems unlikely that MMS would be acting as an intermediary within the meaning set out in section 2 Notice 709/6, although it could possibly be a sub agent within paragraph 2.6 of that Notice. Credit will be given for discussion on this area together with consideration of Revenue & Customs Brief 62/07

Sponsorship

The term “sponsorship” can cover a number of differing activities and it is important to consider carefully which category this income falls under.

The first issue is to differentiate between sponsorship and donations (or grants). Sponsorship implies that the person paying is receiving some tangible benefit in return for the payment (more than just recognition in a brochure for example). Generally this would be in the form of advertising but it could be a whole range of benefits; for example

- naming an event after the sponsor;
- displaying the sponsor’s company logo or trading name;
- participating in the sponsor's promotional or advertising activities;
- allowing the sponsor to use your name or logo;
- giving free or reduced price tickets;
- allowing access to special events such as premieres or gala evenings;
- providing entertainment or hospitality facilities; or
- giving the sponsor exclusive or priority booking rights.

If the sponsors are getting benefits directly linked to the payment of the sponsorship money, it is not an outside the scope of VAT donation; it is then necessary to consider the VAT liability of the sponsorship. The VAT liability of the service will be dependent upon two factors:

1 How the service is classified or characterised (i.e. what it actually is); and

2 Where it is deemed to take place.

As far as I can see, there are three possibilities for this type of supply. It is either:

1 A cultural, artistic, sporting, scientific, educational or entertainment service; or

2 A service relating to an exhibition, conference or meeting; or

3 An advertising service.

If the service falls under either (1) or (2) above then it is deemed to take place **where the service is physically performed**, regardless of where the customer belongs. In my view this would be in the UK, and would usually be subject to standard rated VAT. Where this is supplied to someone outside the EU, then there is scope for recovery of the VAT incurred under the EC 13th Directive, provided the customer does not have a business establishment in the UK.

James White informs me that GotoUK have a place in the UK and so, if the supply is to them in the USA, they would not be able to claim under the 13th Directive. If invoicing to the UK, you should be satisfied that this is the party receiving the supply (see below for 'belonging' rules).

If the service is one of advertising, then it is deemed to take place **where the customer belongs**. Where the customer is either outside the EU, or is in the EU and receives the service in a business capacity, the service takes place where the customer belongs and there is no need to charge UK VAT. If the customer belongs in more than one country then it is the country which is most closely connected with the receiving of the supply which determines where the supply takes place.

Sponsorship Income

Having set out the above, it is then a case of applying the principles to the sponsorship income. The classification depends on what the sponsors are getting for their money. There clearly is a conference and the possibility of a cultural supply, but that does not determine what the sponsors are receiving. If the benefits are in the form of tickets, entertainments, hospitality and events, they will fall under (1) above and will be standard rated supplies in the UK.

Whilst the WAS does involve a conference, I am less persuaded that the supply to the sponsors constitutes services relating to a conference. You are not (so far as I am aware) renting conference space to the sponsors; it is merely a case that they are sponsoring it in return for various benefits. If these benefits mainly relate to displaying the sponsors' name, inclusion in promotional material etc., it is likely to be regarded as a supply of advertising.

Consequently, I think that there is good scope to regard the supply as being within Sch.5 VATA 1994, in which case the VAT liability will be where the customer is based. If this is outside the EU (such as GotoUK's American base rather than their London office), then it will be outside the scope of UK VAT and no VAT will be chargeable. There is support for this interpretation in HM Revenue & Customs Notice 741 which includes as advertising:

'The display of a sponsor's name, or product, by a sponsored person or team in return for "sponsorship" payments.'

I must stress however that the position will come down specifically to what benefits are being provided to GotoUK's US head office rather than their London office, and I have worked on the basis that these are primarily advertising as opposed to (for example) conference space or entertainments. Obviously I would be happy to look at any agreements / documentation that you may have with them.

I hope that the above is of use but please do not hesitate to contact me if you need clarification on any of the points raised.

Kind Regards

Yours Sincerely

Steve Blue

Tax Manager