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# TAX ASPECTS OF RECTIFICATION

**by Barrie Akin**

It sometimes happens that the parties to a transaction execute a written contract which fails to express the true bargain made by them. In the commercial world, such mistakes are easily corrected by entering into a supplementary contract, so long as the parties can actually agree as to what they actually intended. The initial mistake can then be forgotten. Unfortunately, that does not always work from a taxation point of view, particularly when a significant period of time has elapsed between the execution of the contract and the discovery of the mistake – payments may have been made or received in that period. The Revenue may (understandably) take the view that, in taxing or relieving those payments, the provisions in the original contract should be taken at their face value. That is where rectification can come into play.

*Rectification* is the equitable remedy under which the Court orders the correction of instruments (which can include both contracts and trusts) so that their text, *as rectified*, expresses the actual agreement of the parties. The order for rectification enables the parties to point to the *as rectified* text as governing all the acts carried out under the contract, even if those acts took place before the date of the order. This is generally sufficient to persuade the Revenue to look only at the agreement in its rectified state when considering its taxation consequences.

The Court does not, however, hand down orders for rectification at the drop of a hat. It generally[1] requires the Claimant to show five things:-

1. *A prior firm accord, usually outwardly expressed*. If there is insufficient evidence as to what the parties actually agreed, the Court will not rectify the document. The Court does not rewrite bargains to make them more commercially effective;

2. *A common continuing intention up to the time of the execution of the agreement.* It will not do for the parties to have changed their minds between reaching agreement and executing the original agreement. If they did, then the mistake becomes one–sided and the Court will not help;

3. *Clear evidence ("strong irrefragable evidence[2]") that the agreement as executed did not reflect that common intention*;

4. *That the wording contended for by the Claimant will accurately reflect the agreement*; and

5. *That there is an issue between the parties capable of being contested*.

Evidence of the parties' intentions is admissible in rectification proceedings. This is not true in proceedings where the meaning of a document is in dispute[3] –

consequently the Court will not accept flimsy evidence. The burden of proof has been said to be greater than the usual "balance of probabilities" but not as high as "beyond reasonable doubt".

**Tax as a Motive for Rectification?**

Many of the reported decisions on rectification are tax driven. This is not surprising. Even if the parties are able to agree among themselves that an executed document does not express the actual intention of the parties, the Inland Revenue may seek to tax them on the words of the document. That may force the parties to consider rectification as an alternative to arguing away from the meaning of the words used in the document in a tax appeal. The mere fact that the rectification sought will yield a tax advantage to a party is not in itself a bar to relief. See *Whiteside v. Whiteside* [1950] Ch 65 (payments would have been deductible for surtax) and *Re Slocock's Will Trusts* [1979] 1 All E.R. 358 (CTT saving). So the Court will not refuse to make an order on these grounds. But an intention to secure a particular tax result without any clear agreement as to the terms which would secure that result will not do. It will fail as many as four of the Court's requirements. In *Racal Group Services v. Ashmore* 68 Tax Cases 86 there was evidence that the deed of covenant in question had been made with the clear intention that each payment to be made under it should qualify as a charitable covenant that would be a charge on income for the payer. Unfortunately, the payment dates actually chosen and inserted into the deed were not more than three years

apart, so the deed could not qualify and the payments could not be deductible as charges on income. There was no evidence to show that the parties had intended to pay on any other dates, so there could be no rectification. Again, the Court's role is not to recast transactions, but to state them accurately when the parties have failed to do so. It is not sufficient for the mistake to be as to the consequences of the transaction.

This is extremely significant where the parties act in accordance with complex advice – if they do not understand the details of the transaction they are entering into, rectification may not be available. However, more recent decisions are suggesting that this strict approach may be softening. See for example *AMP (UK) v. Barker* [2001] Pens L.R. 77, where Lawrence Collins J described the prohibition on rectification when the mistake is as to consequences as "[i]f anything … simply a formula designed to ensure that the policy involved in equitable relief is effectuated to keep it within reasonable bounds and to ensure that it is not used simply when parties are mistaken about the commercial effects of their transactions or have second thoughts about them. The cases certainly establish that relief may be available if there is a mistake as to law or the legal consequences of an agreement or settlement."

## "Rectifying" by Executing Further Documents

In *Whiteside v. Whiteside* (above) the parties sought to cure the apparent defect in a deed of covenant by executing a supplementary deed. This was fatal to the subsequent claim for rectification because there was no

longer an issue between them. Presumably the Inland Revenue had refused to accept that the supplementary deed could operate retrospectively so as to alter the character of the payments already made.

**Documents That Have Run Their Course**

This is another aspect of the requirement that there must be an issue between the parties. In *Toronto-Dominion Bank v. Oberoi* 75 Tax Cases 244 the 26-month residential lease in respect of which rectification was sought had expired by the time that proceedings were started. This raised the question as to whether there was an issue between the parties – the tenant had paid all amounts due under the lease and had had the use of the premises, which had been occupied by one of its employees. The clearly expressed intention of the parties was that the £345,000 paid in advance to the landlord would be a premium, but the document called it a rent throughout. The tax consequences for both employee and landlord were radically affected, but, that apart, the parties had had their bargain. The High Court held that there was an issue between the parties because the intended premium had been set at £345,000 (significantly in excess of the level of rent) so as to compensate the landlord for the inability fully to deduct mortgage interest against the premium – the premium being taxable at the start of the lease, there was nothing against which mortgage interest could be set in the second and third tax years in which the lease existed. So if the £345,000 payment was not a premium, but was (as the document said) in fact rent, the whole basis on which it was calculated was wrong and the Claimant was

(arguably) able to require that part of it should be repaid. The Court did not decide that the Bank would in fact have been able to recover this "overpayment", but was satisfied that there need only be an arguable case for requirement 5 (above) to be satisfied.

**Evidence**

The requirement for strong evidence that the instrument does not reflect the intention of the parties can present significant difficulties when a particular tax consequence is desired, but the principals have no clear understanding of the steps that will achieve that consequence. In *Toronto-Dominion*, the careful written advice of the Bank's accountants as to what the new lease should do and say was seen by or explained to all parties, except the draftsman of the lease. Had that not happened, the claim would probably have fared no better than the claim in *Racal*.

**Involving the Revenue in Rectification Actions**

Tax-driven rectification actions are usually only necessary when the Revenue insists on taxing in accordance with the executed document or the parties fear that that is what the Revenue will attempt to do. But does an order for rectification bind the Revenue if it is not party to the proceedings? Might the Revenue be able to take a different view of the facts and pursue a tax appeal on the basis of the original instrument? That might be inadvisable in practice, but the Revenue certainly keeps its options open here. In *Slocock* (above), it was not a party, but said in correspondence that it would be bound by the decision "provided that the order

does not appear wrong for any reason". This point tends to be theoretical only, because before launching any rectification action, the parties should ensure that the Revenue is made aware of it and asked whether it wishes to be joined as a party. The stock Revenue response to this is that it does not wish to be joined, but will accept the decision, provided that the relevant authorities are drawn to the Court's attention[4]. But there are occasions where the Revenue does wish to be joined and will argue against rectification. See *Toronto-Dominion*, where the defendants did not oppose the application, but the Revenue did, albeit unsuccessfully.

**Key Points**

1. The commercial temptation to clarify or amend documents can easily prejudice the tax outcome by making rectification impossible.

2. When that happens, the Revenue may refuse to accept that the amendments agreed by the parties have any retrospective force and may accordingly seek to tax on the basis of the original document, at least until the date of the amendments.

3. If the Revenue does take that approach, the precise nature of what was originally agreed would have to be argued before the Commissioners in a tax appeal. Given that there will be a document which contradicts the parties' evidence, the prospects of a successful appeal may be severely compromised.

4. Even if the Commissioners could be persuaded to give rectification "by the back door" after receiving evidence of what the parties actually did intend, it does not follow that the tax outcome would be the same. Some tax outcomes only happen if a document contains prescribed provisions (e.g. pension scheme deeds), and it is difficult to see how the Commissioners could go behind the document in such a case and pretend that an omitted provision was actually present.

5. The later a tax-based rectification claim is brought, the greater the risk that there will no longer be an issue between the parties. If the premium in *Toronto-Dominion* had been for the same amount as the previously negotiated aggregate rental, the outcome might well have been different.

6. It is vital to involve the Revenue in a rectification in some way so as to ensure that, one way or another, it is bound by the result.

7. Even if rectification is obtained, it is important to remember that it does not prevent the Revenue from arguing that the tax treatment of the underlying transaction may be affected by other factors. *Toronto-Dominion* (above) involved the termination of a residential lease at a rent and (as rectified) the granting of a new lease of the same house for just over two years at a premium, with the Bank's employee remaining in occupation throughout. There were provisions for the return of the premium in the event of early termination, which could have occurred if the landlord had returned to the United Kingdom. In theory, the Revenue could,

after rectification was ordered, have argued at the Special Commissioners that the benefits in kind legislation applied to the premium as though it were a rent, either under *Furniss v. Dawson* or as a matter of construction generally, but they chose not to do so.

8. Rectification can have more than one tax effect. In *Toronto-Dominion*, the employee's liability under Schedule E was greatly reduced, but the Schedule A liability of the landlord was increased because he had taxable income in the first year only, with unrelievable interest expenses in the second year. In *Slocock*, there was an improved CTT result, but the retrospective effect of the order redirected past income to two of the parties. The income tax liability would therefore have shifted to them and there would arguably have been nothing to prevent the Revenue from raising discovery assessments on those parties.

9. The position of a person who originally received income, but who, post rectification, was no longer was entitled to it, would have to be taken into account when considering rectification. If they had already paid income tax on that income, an "error or mistake" claim might be possible under s. 33 Taxes Management Act 1970, but that is by no means certain.

10. Even where a rectification action is not tax-based, it may nevertheless have tax effects if the action is successful. Consideration should always be given to the potential taxation effects of any rectification action and to the making of an approach to the Revenue to secure its

acceptance of the consequences of any order of the Court.

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[1] The leading modern authority is *Joscelyne v. Nissen* [1970] 2 Q.B. 86

[2] *Shelburne (Countess) v. Inchiquin (Earl)* 1. Bro. C.C. 338

[3] *Prenn v. Simmonds* [1971] 1 WLR 1381

[4] The Revenue helpfully says which authorities should be cited to the Court: usually *Whiteside*, *Slocock* and *Racal*.

# PAYMENTS FOR SHARE CAPITAL AND S.419 ICTA 1988

## by Felicity Cullen

The Revenue ("HMRC") has recently argued (in more than one matter) that, where an individual ("A") subscribes for shares in a close company ("the Company") on terms that the subscription price is payable by instalments, a liability arises on the Company under s.419 ICTA 1988 (loans to participators etc). HMRC appears to be arguing that a debt equal to the full amount of the future instalments arises when the shares are issued to A. The point has been the subject of recent discussion in *Taxation*, where views as to the correctness or otherwise of HMRC's position were somewhat mixed. For reasons which follow, there should be no liability under s.419 ICTA 1988 in the circumstances under consideration.

Section 419 ICTA 1988 provides as follows:-

> 419 Loans to participators etc.
>
> (1) Subject to the following provisions of this section and section 420, where a close company otherwise than in the ordinary course of a business carried on by it which includes the lending of money, makes any loan or advance to an individual who is a participator in the company, or an associate of a participator, there shall be due from the company, as if it were an amount of corporation tax chargeable on the company for the accounting period in which the loan

> or advance is made an amount equal to 25 per cent of the loan or advance.

Subsection (2) extends the meaning of loan as follows:-

> (2) For the purposes of this section the cases in which a close company is to be regarded as making a loan to any person include a case where –
>
> (a) that person incurs a debt to the close company; .. and then the close company shall be regarded as making a loan of an amount equal to the debt.

On the basis of the typical facts under consideration, the terms of A's subscription would not give rise to a loan or advance by the Company.

Whether or not the Company should be treated, under s.419(2)(a) ICTA 1988, as making a loan to A when he subscribes for the shares in the Company depends upon an analysis of the terms and effect of the terms of the subscription as a matter of general and company law. As a matter of general law, one would expect A to incur a prospective liability for future instalments of subscription price on subscribing for the shares in the Company; but one would expect a debt to arise only once a particular instalment had become due but had not been paid. This analysis is consistent with the circumstance that the Company could not sue in debt until each instalment became due. Company law reinforces the conclusion that there is no debt within the meaning of s.419 ICTA 1988 (even as extended by

s.419(2)(a) ICTA 1988) until each instalment for the shares becomes due and payable by A. As a matter of company law, a member of a company is bound to pay the full amount unpaid on his shares, but unless the terms of issue so provide, he is not bound to pay up at once and is only bound in accordance with the Articles of Association of the Company: s.14 Companies Act 1985 ("CA 1985"). When the liability to pay (under s.14 CA 1985) has matured, the shareholder's liability to the Company matures into a specialty debt. In the case of a liability which arises under a call, the liability does not mature into a debt until the call is made: *Whittaker v. Kershaw* (1890) 45 Ch.D 320 at 326.

In modern practice, the use of calls on shares is not frequently adopted. Instead, terms of issues of shares normally provide that what is outstanding on shares shall be paid by fixed instalments. This method has both financial and commercial conveniences. Strictly, an instalment payable at a fixed date by the terms of issue of a share is not a call, but the Articles of companies usually provide that any sum payable in respect of a subscription for shares at a fixed date shall be deemed to be a call duly made and payable on the date on which it became due; and in the case of non-payment of an instalment, the provisions of the Articles dealing with the consequences of non-payment of a call shall apply (Table A Article 16 and Palmers Company Law 6.202 – "Instalments and Calls"). To the extent that they govern the rights and duties of members, Articles of Association operate as a contract between a member such as A, and a company such as the Company (s.14(1) CA 1985). The

effect of Table A Article 16 is to provide, as a matter of the contract between A and the Company, that no debt is incurred by A until calls or instalments (which are treated as calls) become due. Further, where the Company has issued shares on terms that the issue price is to be paid by fixed instalments, it cannot call up the instalments before they are due in reliance on a general power to make calls conferred by the Articles: *Re: Cordova Union Gold Company* [1891] 2 Ch 580. When shares are issued for payment by instalments, the natural inference is that the shares are partly paid to the extent of each instalment, and the treatment of instalments as calls in accordance with Table A Article 16 supports this analysis.

Section 738 CA 1985, however, deals with allotment and payment up of shares as follows:-

> 738. "Allotment" and "paid up"
>
> (1) In relation to an allotment of shares in a company, the shares are to be taken for the purposes of this Act to be allotted when a person acquires the unconditional right to be included in the company's register of members in respect of those shares.
>
> (2) For the purposes of this Act, a share in a company is deemed paid up (as to its nominal value or any premium on it) in cash, or allotted for cash, if the consideration for the allotment or payment up is cash received by the company, or is a cheque received by it in good faith which the directors have no reason for suspecting

> will not be paid or is the release of a liability of the company for a liquidated sum, or is an undertaking to pay cash to the company at a future date.
>
> (3) In relation to the allotment or payment up of any shares in a company, references in this Act (except sections 89 to 94) to consideration other than cash and to the payment up of shares and premiums on shares otherwise than in cash include the payment of , or any undertaking to pay, cash to any person other than the company.
>
> (4) For the purposes of determining whether a shares is or is to be allocated for cash, or paid up in cash, "cash" includes foreign currency.

It has been suggested in *Taxation* that s.738 CA 1985 requires the full amount of the subscription price to be recognised at the outset and requires the shares to be treated as fully paid. Section 738 CA 1985 does not, however, require this treatment. Section 738 CA 1985 is an interpretation section of CA 1985 (as part of "Part XXVI – Interpretation") and simply extends the meaning of payment up in cash to include "good" cheques, releases of liabilities of the Company and undertakings to pay cash in future. The distinction between payment in cash and payment otherwise than in cash is material to provisions such as s.103 CA 1985 (dealing with valuation of non-cash consideration before allotment) and s.88 CA 1985 (dealing with returns as to allotments). Section 738 CA 1985 does not refer to "partly paid" or "fully paid" or to the distinction between the two; and it

would be logically incorrect to describe shares on which instalments are outstanding as fully paid. On the basis of Table A Article 16, such shares will not even be treated as fully called, and it would, therefore, be irregular to describe them as fully paid. In the circumstances, the s.738 CA 1985 point is something of a red herring in the context of HMRC's arguments concerning s.419 ICTA 1988: and there is no liability under s.419 ICTA 1988 on instalments on shares which have not yet become due.

In addition to the point concerning the time at which a debt arises in the context of shares issued for payment by instalments, there is a further defence to liability under s.419 ICTA 1988, where A is not an existing shareholder at the time at which he subscribes for shares in the Company for payment in instalments. Even if (contrary to the view expressed above), the Company is, by reason of s.419(2)(b) ICTA 1988, to be regarded as making a loan to A when he subscribes for the shares, this is not sufficient for liability under s.419 ICTA 1988. It is necessary for A to be a participator in the Company when it is "regarded as making a loan" to him if liability is to arise under s.419(1) ICTA 1988: "where a close company makes any loan … to an individual who *is* a participator …". The term "participator" is defined in s.417(1) ICTA 1988 as follows:-

> (1) For the purposes of this Part, a "participator" is, in relation to any company, a person having a share or interest in the capital or income of the company and

> without prejudice to the generality of the preceding words, includes –
>
> (a) any person who possesses, or is entitled to acquire, share capital or voting rights in the company;
>
> (b) any loan creditor of the company;
>
> (c) any person who possesses, or is entitled to acquire, a right to receive or participate in distributions of the company … or any amounts payable by the company … to loan creditors by way of premium on redemption; and
>
> (d) any person who is entitled to secure that income or assets (whether present or future) of the company will be applied directly or indirectly for his benefit.
>
> In this subsection references to being entitled to do anything apply where a person is presently entitled to do it at a future date, or will at a future date be entitled to do it.

In the usual case A will not, when he subscribes for shares in the Company – when the Company might be regarded as having made a loan to him – be a participator within the meaning of subparagraphs (a) to (d) of subsection (1) of s.417 ICTA 1988 above, and, until he has subscribed for shares, he will not be entitled to acquire anything either presently or at a future date. Further, he is not, at the relevant time, "a person having

a share or interest in the capital or income of the company" within the general words of s.417(1) ICTA 1988. If (as is not considered to be the case) it is correct that A incurs a debt to the Company on subscription, he incurs that debt by the very act which makes him a participator in the company; and s.419 ICTA 1988 does not apply to a person unless he *is* a participator when the loan is made to him (or debt is incurred by him).

## Conclusion

A, who subscribes for shares in the Company, is not at the time at which he subscribes for shares, a participator in the Company; and even if the shares acquired are to be paid for in instalments, A does not incur a debt to the Company at the time of subscription. The terms of A's subscription do not constitute the sort of mischief at which s.419 ICTA 1988 is aimed: it was aimed at preventing existing shareholders extracting funds from a close company in otherwise non-taxable forms. A purposive construction of s.419 ICTA 1988, therefore, reinforces the technical analysis provided above and the conclusion that s.419 ICTA 1988 does not apply in the situations in which HMRC is arguing that it does.

## DOUBLE TAX TREATIES AND SS.739 AND 740 ICTA 1988

**by David Goy**

Difficult questions arise as to whether the provisions of a double tax treaty can protect against charges to tax otherwise arising under anti-avoidance provisions. This note is concerned with the application of such treaties to charges otherwise arising under sections 739 and 740 ICTA 1988.

While there is no direct judicial authority (higher than the Special Commissioners) that has considered this issue, relevant authority is to be found in the case of *Bricom Holdings Ltd v IRC* 1997 STC 1179 ("*Bricom*"). This case was concerned with the question of whether the interest article in the Dutch Treaty prevented interest being taken into account in assessing chargeable profits for the purposes of the controlled foreign company ("CFC") legislation. The Court of Appeal concluded that the interest in question was not included in the sum apportioned under the CFC legislation. It was merely a measure by which an element in a notional sum was calculated and it was that notional sum which was apportioned and on which tax was charged. As the interest in question was not chargeable to tax the double tax treaty provided no relief.

Having reviewed a number of authorities Millett LJ (as he then was), said the following:-

> "…these cases show that the question turns on the nature of the statutory process. Interest from exempt securities does not cease to be such by being included as a component element of the recipient's taxable profits (see [*Hughes v Bank of New Zealand* 1938 AC 366]). Exempt income does not change its character or lose its exemption merely because it is deemed to be the income of another person or is imputed to him (see *Lord Strathalmond v IRC* [1972] 1 WLR 1511]). But where tax is charged on a conventional or notional sum which exists only as a product of a calculation, the fact that one of the elements in the calculation is measured by reference to the amount of exempted income does not make the exempted income the subject of the tax (see [*IRC v Australian Mutual Provident Society* [1947] AC 605])."[1]

The Court of Appeal's conclusion that the interest in question was merely an element in a calculation led directly to its decision that the Dutch Treaty provided no protection from charge. While it may seem rather odd that a treaty can protect where the income in question is directly the subject of charge but not where what is chargeable are amounts measured by reference to such income, this, nevertheless, is the result of *Bricom*.[2]

For present purposes what is of particular relevance is what *Bricom* said about the *Strathalmond* case. In that case the taxpayer's wife was resident for tax purposes in the United States and under the treaty with the USA her American dividend income was exempt from tax in the UK. The taxpayer was assessed to tax on the income but

the assessment was discharged on the basis that the treaty protected. Referring to this case in *Bricom*, Millett L J said:-

> "…the case shows that the relief from United Kingdom Tax accorded by a double taxation agreement can enure for the benefit of a third party. But the taxpayer in that case was directly assessable on his wife's income, which the relevant statutory provisions [… now repealed] deemed to be the income of her husband."[3]

Turning away from the CFC legislation to section 739, the principal point to be considered is "the nature of the statutory process". In this context the process appears to be very different from that applicable in the CFC legislation. Under section 739(2), where an individual has power to enjoy the income of a non-resident then…

> "…that income shall… be deemed to be income of that individual for all the purposes of the Income Tax Acts."

A like deeming provision operates under s.739(3) where capital sums have been received. The effect of the deeming provisions is therefore to make the individual directly assessable on the income in question. The income is not merely an element in a calculation as was the position in *Bricom*. On this basis there would appear no reason why, at least in theory, a double tax treaty cannot protect against a charge under section 739. Ultimately however, the protection of the treaty will not only depend upon the statutory process referred to above, but also upon whether upon a proper construction of the

treaty itself, it can protect the particular taxpayer and the particular income from charge.

On the basis of what is said in *Bricom,* there appears to be no particular difficulty in concluding that a treaty can protect against charges arising under Section 739. The Revenue, however, are known to take a different view, invoking, in particular, the approach of the Special Commissioners in *IRC v Willoughby 1995 STC 143.* While this case is better known for what it says about tax avoidance, one issue raised before the Special Commissioners, but not the subject matter of appeal, was whether the Treaty with the Isle of Man prevented the profits of a Manx enterprise from being deemed to be income of the taxpayer under Section 739. The Special Commissioner said no. He said:-

> "In my opinion there is a distinction between actual income of an individual and actual income of another person which is deemed to be income of the individual. Such income is not industrial or commercial profits of the individual nor quoad the individual is it deemed to be industrial or commercial profits or deemed to be his income as if it were such profits".[4]

Such an approach appears to run counter to the approach adopted in *Strathalmond* and approved in *Bricom.* There is nothing to prevent the income of one person which is deemed to be that of another under Section 739, from being protected by a treaty. It is also worth noting that the absence of an appeal against the decision in *Willoughby* on this issue did not represent

any acceptance on the taxpayer's part that the Special Commissioner's approach was correct.[5] As proved to be the case, the taxpayer had clearer arguments to put forward. As a factual matter, the income deemed to be the taxpayer's if Section 739 applied, only fell to be included in the Manx company's profits to a small extent. A large part of it was an expense for the Manx entity as it operated to enhance the value of the taxpayer's investment. Only the net surplus was taxable in the Isle of Man. The argument that the treaty protected could not be put forward in the most ideal context.

Necessarily the question of whether what is chargeable under Section 739 is the same income as that protected by a treaty, is a matter of construction in each case. Even if an issue as to this arises in the context of 'industrial and commercial profits', it is unlikely to arise in the context of other categories of income such as dividends and interest where there is an obvious and direct equivalence between what is regularly protected by a treaty and what Section 739 brings into charge. Even in the context of 'industrial and commercial profits' the position is by no means clear. As mentioned by Millett L J in *Bricom,* the case of *Hughes v Bank of New Zealand* indicates that interest from exempt securities does not cease to be such by being included as a component in a person's profits. By analogy it can be argued that if a person's profits are protected from charge so is any component element in it.

In *Bricom* the Special Commissioners made reference to *Willoughby* and said of it:-

> "Income which was 'industrial and commercial profits' of one person was deemed by S.739 to be income of another person, but its character as industrial and commercial profits was not preserved as it was charged to tax in the hands of the deemed recipient under Case VI of Schedule D".[6]

It is not considered that there is anything in this point. The specific charging provisions under Section 739 do not change the character of the income charged to tax. If interest earned by a foreign company is deemed to be that of a UK resident under Section 739, it is the identical income that is taxed whatever the precise head of charge. In any event, it should be noted that the basis of the charge has been altered and Section 743 (1) now merely provides that " …. Income to which Section 739 applies shall be charged to income tax". If there ever was anything in the point it is no longer there.

In the circumstances, there is nothing in anything the Special Commissioners have said in either *Willoughby* or *Bricom* which demonstrates that as a general principle a treaty cannot protect against a Section 739 charge. Whether it does so in fact, will depend upon the precise provisions of the treaty being relied on.

Turning now to Section 740, the first issue to be considered is again the nature of the statutory process adopted. Here the position is different from Section 739. Section 740, when it applies, taxes the amount or value of benefits provided out of assets available for the purpose by reason of transfers of assets abroad. The

charge on the benefits received is limited to the extent to which there is 'relevant income' arising in consequence of which benefits can be provided. What is charged to tax is not, however, the 'relevant income' itself but rather the amount or value of the benefits in question. In these circumstances, adopting the approach of the Court of Appeal in *Bricom,* it would not appear that any treaty relief applicable to the underlying income can protect against a charge to tax on the benefits in question. The income in question limits what may be chargeable but tax is not ultimately charged on the income itself.

In the circumstances, the writer's conclusion is that a treaty can protect in appropriate circumstances, against a charge under Section 739 but not under Section 740. There appears to be no good policy reason why this should be so but it appears to follow from the different wording of the two provisions and the narrow approach adopted in *Bricom.*

As postscript, it is worth making reference to the compatibility of the provisions in Section 739 and 740 with the EU Treaty. A like issue has already arisen in the context of the CFC legislation in the cases of *Cadbury Schweppes*[7] and *Vodafone*[8] in which it has been argued that such legislation constitutes a breach of the freedom of establishment in Article 43 of the EC Treaty, a breach of the freedom to provide services under Article 49, and a breach of the freedom of movement of capital and payments under Article 56. These issues have now been referred to the European Court of Justice. Like arguments may be available in the context of Section 739

and 740. In some respects the arguments may be stronger in these cases. Where these provisions apply, income tax rates of up to 40 per cent can in effect be levied on the income of foreign companies. If such income arose to UK resident companies the maximum rate would be thirty per cent corporation tax. This may be contrasted with the CFC legislation, the effect of which in broad terms is to subject the parent company concerned to no more tax than if the foreign companies were resident in the UK.

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[1] 1997 STC 1179 at p1195
[2] A like approach did not appeal to the French Court in *Re Société Schneider Electric 2002 ITLR 1077*
[3] Supra @ p.1195
[4] 1995 STC 143 at p 169
[5] The writer of this note appeared with Philip Baker in *IRC v Willoughby* as counsel for the taxpayer.
[6] 1997 STC 1179 at p 1186
[7] [2004] STC (SCD) 342
[8] [2006] STC 483

## *COLLEGE OF ESTATE MANAGEMENT v. CUSTOMS & EXCISE COMMISSIONERS* [2005] STC 1597

## CASE NOTE AND COMMENTARY

**by Nicola Shaw**

The College of Estate Management is a leading provider of distance learning courses in the field of property management and construction. The teaching provided by the College includes:-

(a) study at home or in the workplace using materials provided by the College;

(b) preparation and submission of assignments;

(c) attendance at face-to-face teaching sessions; and

(d) access to the College's "virtual learning environment" provided on its website.

It was common ground between the parties that the College made supplies of educational services to its students. These supplies were exempt for VAT purposes with the consequence that no input tax in respect of them could be recovered. The area of dispute was as to whether or not the College also made a separate zero-rated supply of printed materials, thereby entitling it to reclaim input tax incurred in relation to those supplies. The House of Lords held that although the written

materials were an essential part of the supply made by the College, they were nonetheless only a component part of what was, as a matter of economic reality, a single supply of education services.

The case explores the "authoritative guidance" of the ECJ in *Card Protection Plan v. CCE* (Case C-349/96) ("*CPP*") and is extremely helpful in breaking down the particular analytical approaches to different types of single supply cases. Their Lordships stressed the importance of not straining judicial language or attempting to force every supply into one descriptive pigeon-hole. Since the Judgment of the ECJ in *CPP*, the question of whether a transaction amounts to a single supply or multiple supplies has been before the House of Lords on no fewer than five occasions[1]. It is extremely well-trodden ground and yet a definitive answer as to the correct approach to determining the matter remains elusive.

As Lord Walker of Gestingthorpe, who gave the leading judgment, held "this is an area in which it is unwise to attempt any exhaustive schematic analysis"[2] (). This echoes Lord Hoffmann's comments in *Dr. Beynon and Partners v. CCE* [2004] 4 All ER 1091 at paragraph 20. However, the "schematic analysis" suggested by their Lordships in *College of Estate Management* is at the very least a very insightful starting point. The analysis involves dividing the single supply cases into two categories:-

(i) principal/ancillary cases, exemplified by *CCE v. Madgett and Baldwin (trading as*

*Horndean Court Hotel)* Joined Cases C-308/96 and C-94/97, *CCE v. British Telecommunications* [1999] 3 All ER 961 and *CPP*; and

(ii) component part cases, exemplified by *Faaborg-Gelting Linien A/S v. Finanzant Fleursborg* Case C-231/94, *Dr. Beynon* and now *College of Estate Management*.

In assessing the nature of a transaction, the following principles should be borne in mind:

(i) the essential features of the transaction must be ascertained to establish whether the transaction is a single supply or a number of distinct supplies;

(ii) a supply which comprises a single service from an economic point of view should not be artificially split; and

(iii) every supply of a service is normally to be regarded as distinct (see para.29 of *CPP*).

**Category (i) Cases**

The classic exposition in relation to this type of case is found in paragraph 30 of the ECJ's judgment in *CPP*:

> "There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal

> service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principle service. A service must be regarded as ancillary to a principal service if it does not constitute for customs an aim in itself, but a means of better enjoying the principal service supplied."

In the High Court appeal in *College of Estate Management* [2004] STC 235, Lightman J described this type of case as an "add-on" supply. The ancillary element is an "add on" to the principal supply. This is a helpful way of analysing the nature of these types of transactions, although, as Lord Walker pointed out in the House of Lords, the notion of an "add on" element is wide ranging in its nature: an "add on" may be optional (like certain in-flight catering ) or it may be indispensable (like a car's ignition key)[3]. Lord Walker described the term "ancillary" as meaning "subservient, subordinate and ministering to something else"[4]. Lord Rodger described an ancillary element as an "accessory" to the principal supply[5]. So, the use of the term "ancillary" was entirely appropriate to describe the transport element supplied by a hotelier to his customers (*Madgett and Baldwin*), the delivery element of the sale of the car (*BT*) and the labels, key tags and medical cards within a package of insurance services (*CPP*). Furthermore, it would seem that a relevant factor in assessing whether or not an element can be described as "ancillary" to a principal supply is its proportionate value to the overall package price. In *Madgett and Baldwin* the ECJ considered that an ancillary supply would only account for a small proportion of the total

price[6], and certainly in both *BT* and *CPP* the ancillary elements constituted insignificant proportions of the total package prices. And most recently, in the case of *Levob Verzekeringen BV v. Staatssecretaris van Financiën* Case C-41/04, the ECJ has listed cost as one of a number of factors (in the context of a supply of a customised software programme – the other relevant factors being the importance of the customisation to the purchaser and the extent and the duration of the customisation) relevant to the determination of the question of single supply or multiple supplies. Quite how important a part this particular factor will play in an analysis of Category (i) cases is unresolved. The Court of Appeal has just granted permission in relation to an appeal concerning this very point[7], so we can expect further developments still in this area. However, in my opinion, the question of whether or not an element is ancillary to a principal supply fundamentally boils down to the economic reality.

In *College of Estate Management* Lord Rodger considered that it would be "highly artificial" to describe the printed materials as "ancillary" to the principal supply of education services. The correct analysis was not that the materials were simply a better means of enjoying the supply of education, because the materials were the means by which the students obtained the supply of education. Rather, the correct analysis was to ascertain whether the essential features of the transaction pointed to a single supply or a bundle of separate supplies.

## Category (ii) Cases

Even if an element cannot be described as "ancillary" to a principal supply, it does not necessarily follow that it must be regarded as a separate supply[8]. An element may be an essential (as opposed to a subordinate) element of a transaction but nonetheless, as a matter of economic reality, simply part of an overarching single supply. As Lord Walker acknowledged[9], food is an integral part of restaurant services (*Faaborg-Gelting*) as are pharmaceuticals to the provision of medical care (*Dr. Beynon*): a restaurant with no food or a doctor without medicines are contradictions in terms. And yet, unquestionably, the nature of what is being supplied in each case is a single supply of restaurant services and medical care. Likewise, in *College of Estate Management*, although the written materials could not "on any sensible use of the word" be regarded as ancillary, they were nonetheless still simply part of an overall package of education services. The written materials were integral to that supply in that they were the mechanism by which those services were supplied. But the economic reality was nonetheless that there was a single supply of services of which the written materials constituted a component part.

## Conclusion

Even if the analysis can all be reduced to matters of economic reality, it would be naïve to assume that future determinations of single supply cases will necessarily be easier. Whilst the notion of "economic reality" is a fairly simple one, it can of course be notoriously difficult to

apply. One person's view of the economic reality can be quite removed from another person's view. Indeed, this is very often at the heart of any dispute between a taxpayer and the Commissioners.

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[1] *CCE v. British Telecommunications* [1999] 3 All ER 961; *CPP v. CCE* [2001] 1 All ER 143, *CCE v. Plantiflor Ltd* [2002] STC 1132, *Dr Beynon and Partners v. CCE* [2004] 4 All ER 1091 and *College of Estate Management v. CCE* [2005] STC 55
[2] See paragraph 33 of the judgment
[3] See paragraph 33 of his opinion
[4] See paragraph 30 of his opinion
[5] See paragraph 11 of his opinion
[6] See paragraph 24 of the judgment
[7] *International Masters Publishers Ltd v. HMRC*
[8] See Lord Rodger's opinion at paragraph 12
[9] See paragraph 30 of his opinion

# IF *RAMSAY* WERE IN STATUTORY FORM

**by Patrick C Soares**

The *Ramsay* approach to statutory interpretation, which has evolved over the last 20 years, is not easy to tie down. If it were to be in statutory form at present it may look like the section set out below. Perhaps an important feature of the approach is that it has to stay nebulous. It was given some of the attributes of a statute by Lord Brightman in *Furniss v Dawson* [1984] STC 153 at 166, but Lord Nicholls in *MacNiven v Westmoreland Investments* [2001] STC 237 pointed out the dangers of this at page 243[8] where he said:-

> "It would be wrong ... to set bounds to the circumstances in which the Ramsay approach may be appropriate and helpful".

That said, there is an irresistible temptation for tax advisers to reduce nebulous concepts to something which they can deal with – something which takes a statutory form. Having succumbed to that irresistible temptation, I hope that the draft section set out below will help practitioners to ensure they take into account all the relevant features of the *Ramsay* approach in determining whether it applies to a particular set of transactions.

## The *Ramsay* Section

*Section 1 Anti-Avoidance*

(1) This section is designed to prevent the avoidance of tax.

(2) This section applies if:-

(a) there is a pre-ordained series of transactions; and

(b) steps are inserted into the pre-ordained series of transactions which have no commercial (business) purpose apart from the avoidance of a liability to tax.

(3) Where this section applies steps inserted into the pre-ordained series of transactions exclusively for tax avoidance purposes are disregarded for tax purposes and the end result shall be looked at to determine how the provisions of the particular taxing statute shall be applied.

(4) Instead of just disregarding exclusive tax avoidance steps to counter the tax avoidance the courts can in addition or in the alternative recharacterise the tax avoidance steps in order to determine how the particular taxing statute shall be applied.

(5) In determining whether there is a pre-ordained series of transactions steps introduced therein for no commercial purpose other than to take away the element of preordination shall be treated as part of the pre-ordained series of transactions.

(6) If the particular transaction could have been carried out in two or more ways both or all of which would have avoided tax but the taxpayer was genuinely uncertain as to which way to adopt the element of preordination may be absent.

(7) Steps can only be ignored or re-characterised if it is intellectually possible to do this taking into account the final state of affairs which will exist after the excision of the tax avoidance steps and/or the recharacterisation of the steps.

(8) In situations where Parliament intended the tax legislation in question to be construed without taking into account the existence of a pre-ordained series of transactions the existence of a pre-ordained series of transactions shall not be taken into account in construing the tax legislation in question.

(9) A pre-ordained series of transactions includes cases where there is an arrangement that the series of transactions be carried through even though the parties are not contractually bound to take the steps in the series of transactions.

(10) Tax for the purposes of this section includes income tax, capital gains tax, corporation tax, stamp duty, stamp duty reserve tax,

stamp duty land tax, inheritance tax and value added tax.

(11) The section is deemed always to have had effect.

## Commentary on the *Ramsay* Section and Relevant Case Law

**Subsections (1) & (2):** *Ramsay Ltd v IRC* [1981] STC 174 and *Furniss v Dawson* [1984] STC 153 at 166 g&h laid down the basic structure of the Ramsay approach to statutory interpretation; *MacNiven v Westmoreland Investments* [2001] STC 237 at 243[7] and [8], *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1 at 14[42] and *IRC v Scottish Provident Institution* [2005] STC 15 at 26 [23] cleared away the cobwebs which had grown over the approach over its first 20 years of evolution.

**Subsection (3):** "exclusive tax avoidance step", see *Craven v White* [1988] STC 476 at 508(e) and *IRC v McGuckian* [1997] STC 908 at 917 (f).

**Subsection (4):** "recharacterise steps", see *IRC v McGuckian*: Lord Cooke at 919d and Lord Clyde at 992c.

**Subsection (5):** if taxpayers introduce steps into the transaction to take away the element of pre-ordination and there is no commercial basis for those steps there will still be a pre-arranged scheme caught by the section:

*IRC v Scottish Provident Institution* [2005] STC 15 at 26[22].

**Subsection (6):** *Craven v White* [1988] STC 476 at 509c

**Subsection (7):** *Piggot v Staines Investments* [1995] STC 114 at 140j; *Craven v White* ibid at 508j at 509g and *Fitzwilliam v IRC* [1993] STC 502 at 513j.

**Subsection (8):** *MacNiven v Westmoreland Investments Ltd* [2001] STC 237 at 255[58] and 256[59] and *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1 at 14[42].

**Subsection (9):** *Furniss v Dawson* ibid at 166 and *McNiven v Westmoreland Investments Ltd* ibid at 242[3].

**Subsection (10):** Some taxes such as stamp duty and value added tax are more likely to come within subsection (8) than others: *MacNiven v Westmoreland* ibid at 255[58].

**Subsection (11):** As the *Ramsay* approach is no more than an approach to statutory interpretation it is timeless: *MacNiven v Westmoreland* ibid at 243e.

# STAMP DUTY LAND TAX ("SDLT") AND PARTNERSHIPS: AN INTRODUCTION

**by Michael Thomas**

## Introduction

The SDLT regime for partnerships is a very unsatisfactory area of law. It is also in a state of flux, both because there is considerable uncertainty as to how the law currently applies and because the Finance (No. 2) Bill 2006 contains proposed changes. However, if enacted – as expected – the proposed changes will at least serve to reduce two of the areas of uncertainty. This article is meant to be introductory and is intended primarily for those who have not yet had the misfortune to have to study this area of law in detail or to apply in practice. My aim is to outline the SDLT partnerships regime, to highlight some areas of difficulty and to deal with the proposed changes in the Finance (No. 2) Bill 2006.

The history of the provisions demonstrates that those responsible for SDLT have struggled to provide a satisfactory regime to deal with partnerships. As readers will be aware, SDLT originally contained no charging provisions dealing with partnerships, and the old stamp duty regime was initially kept in place for partnerships. The reason for this was that it was thought too difficult to enact legislation in time for the implementation of SDLT on 1 December 2003. Draft legislation was published, which followed the principle that a charge should be levied on the market value of the land interest

transferred. However, this principle was largely abandoned in the legislation which was enacted in FA 2004 as Part 3 Schedule 15 FA 2003. This legislation, which I shall refer to as the "current law", is deeply unsatisfactory and riddled with complications and uncertainties. HM Revenue and Customs ("HMRC") acknowledge this, although in practice this acknowledgement has given rise to further problems, in that, by trying to achieve fair results, HMRC have caused further confusion by presenting as interpretations what are in substance concessions. The changes proposed in Budget 2006 will remove some of these difficulties and are to be welcomed. However, they will not be the last word on what remains a difficult area of law.

**General Rules Concerning the application of SDLT to Partnerships**

The first issue is whether a partnership, which for SDLT purposes includes a limited partnership or an LLP, exists. The starting point is whether a business is carried on "in common", in the sense of an agreement to share profits and losses, with a view to profit: see s.1(1) Partnership Act 1890. As a general rule, taxpayers will wish to avoid creating a partnership unwittingly for SDLT purposes. This is an important point to consider when a joint venture involving land is being proposed. The general rule is that a partnership is treated as transparent for SDLT purposes so that land is held by the partners. Where a partnership purchases land from a

third party then SDLT is payable in the usual way and the partners are liable.

**Special Charging Regime for Partnerships**

The SDLT partnerships regime contains 3 main occasions of charge:-

(1) The transfer of land to a partnership by a partner;

(2) The transfer of an interest in a partnership;

(3) The transfer of land from a partnership to a partner.

When SDLT was enacted, the most important new charge was made by (2), which prevented the avoidance of stamp duty by the old technique of dropping land into a Jersey partnership and selling partnership interests. The charges under (1) and (3) are mirror images of one another: both contain special rules for rental leases and partnerships consisting entirely of bodies corporate. Part 3 Schedule 15 contains special charges for each of transactions (1) to (3), notwithstanding that charges would arise on general principles (because a partnership is treated as transparent) provided that it was put beyond doubt that a variation in a partner's interest in a partnership in consequence of a land transfer amounts to the giving of consideration. One can see that the general principle is meant to be that a charge should be levied on the proportion of the market value of the land which is

effectively transferred. Unfortunately, that is not what the current law provides, as regards charges (1) and (3) above. However, the market value principle should be restored if the changes proposed are enacted.

## Charge on Transfer of Land to a Partnership by a Partner

### *The Current Law*

The first issue is to determine when land becomes "partnership property." Uncertainty arises where land used by a partnership is not partnership property as a matter of general law. Land is partnership property for SDLT purposes when it is "*held by or on behalf of a partnership, or the members of a partnership, for the purposes of the partnership business:*" see para 34(1) Sch. 15 FA 2003. HMRC's view is that this is an 'economic use test', so that land owned by one of the partners is partnership property if it is used by the partnership. This catches, for example, an arrangement such as that featured in *Harrison-Broadley v Smith* [1964] 1 All ER 867, where agricultural land is held by a partner outside a family farming partnership. HMRC's view is extremely controversial and hotly disputed: the partner who owns the land may, for example, hold it primarily for investment purposes. In the author's view, land held outside the partnership will generally not be partnership property, although there may be limited exceptions to this, such as where land is held on some sort of "shadow partnership" arrangement for the purposes of avoiding SDLT. For present purposes the important point to be aware of is that SDLT may be in

point even where land is held outside a partnership as a matter of general law.

Tax is currently charged by determining the chargeable consideration, using the formula contained in para 10 Sch. 15 FA 2003:-

> The chargeable consideration for the transaction shall (subject to paragraph 13) be taken to be equal to –
>
> (RCP x MV) + (RCP x AC)
>
> where –
>
> > RCP is the relevant chargeable proportion,
> >
> > MV is the market value of the interest transferred, and AC is the actual consideration for the transaction.
>
> The relevant chargeable proportion in relation to the market value of the interest transferred is –
>
> (100 – SLP) %
>
> where SLP is the sum of the lower proportions.
>
> The relevant chargeable proportion in relation to the actual consideration for the transaction is –
>
> SLP **%**

> where SLP is the sum of the lower proportions.

It is necessary to go through a tortuous three-stage process to determine the Sum of the Lower Proportion ("SLP"), but – to put it shortly – the SLP is the proportionate share of the land treated as retained by the transferor-partner (or persons connected with him).

What amounts to "actual consideration" is another controversial issue. The better view is that the legislation uses the term to contrast with deemed consideration, so actual consideration is anything given to the transferor-partner in return for the land. It is generally accepted that an increase in a partner's share in the partnership and any credit to a partner's capital account do not count as actual consideration. This is both helpful to taxpayers and generally accepted, but the basis for it is unclear. In addition, HMRC controversially takes the view that actual consideration is only chargeable where the partners are connected (and therefore a charge based on market value will not arise) – "connected" for these purposes having the meaning as in ICTA 1988 s.839. Para 33700 of HMRC's draft manual provides as follows:

> **SDLT TM33700 What is the actual consideration to be taken into account?**
>
> Consideration is only actual consideration where the sum of the lower proportions (SLP see SDLTM33700) is higher than it otherwise would be because the transfer is to

a partnership where one or more persons is connected with the transferror.

Thus where a property is transferred by a parent into a partnership of their offspring, the sum of the lower proportions will be 100 and the market value charge will be nil.

If the partnership or partners make a payment to the parent, this payment is actual consideration.

Actual consideration can take the usual forms of consideration, that is

- monetary payment
- assumption or release of debt
- property in exchange

It does not matter whether the payment is made by the partnership directly or by the partners individually, if the payment is for the transfer.

This means that there can never be actual consideration when the transfer is by a partner into a partnership and there are no connected persons.

This view is helpful to taxpayers but there is no basis for it in the legislation as it currently stands.

*Proposed Reform*

If the Budget 2006 changes are enacted, the charge on "actual consideration" where land is transferred to a partnership by a partner will be abolished from the date of the Royal Assent. The charge will then be only by reference to the market value. Para. 2 Sch. 24 of the Finance (no. 2) Bill 2006 substitutes the charging formula set out above with the following:-

> The chargeable consideration for the transaction shall (subject to paragraph 13) be taken to be equal to –
>
> MV x (100 – SLP)%
>
> where –
>
> MV is the market value of the interest transferred, and
>
> SLP is the sum of the lower proportions.

Where a rental lease is involved, the current charge on that proportion of the net present value of the rent which corresponds to the share in the land treated as transferred will be retained, but there will be no charge on any other actual consideration. Minor amendments will also be made to the relevant parts of Schedule 15 to accommodate this change.

**Example**

Suppose that A and B farm land in partnership. C joins

the partnership, taking a one third equal share in return for contributing land worth £1 million. Once the proposed changes are enacted, it will be clear that the charge is on £666,666, being the value of the two-thirds share in the land which C is treated as transferring. This assumes that C is not connected to A and B.

If C were connected to A and B, then on the current law, supplemented by HMRC's practice, the charge would be on any actual consideration, but it is proposed that this charge on actual consideration will be abolished. So, if C were paid £600,000 for transferring the land, then currently a charge (of £24,000) would arise – if C were connected to A and B, whereas once the proposed changes are enacted then no charge will arise.

## Charge on Transfer of Land from a Partnership to a Partner

The charge on the transfer of land from a partnership to a partner or a person connected with him operates in essentially the same way as the charge in the reverse situation described above. The partner is charged on the market value of the land which he is treated as acquiring. Currently there is also a charge on the inverse proportion of any actual consideration but it is again proposed that this charge will be abolished.

## Transfer of a Partnership Interest

An SDLT charge arises where consideration is given for the transfer of a partnership interest, when the

partnership assets include UK land. Tax is charged not on the consideration, but on the proportion of the market value of the partnership land equal to the increased partnership share. Again, there is controversy and uncertainty over the scope of this charge. The statute contemplates a rights-based approach to determine whether an interest in a partnership is transferred. However, HMRC takes an inconsistent approach in relation to the two limbs of charge on the transfer of a partnership interest under para 36 Sch 15. HMRC says that partnership interest means the "cash equivalent" value of a partner's rights in relation to a straightforward transfer of an interest in a partnership. In contrast, where a new partner joins and a partner reduces his interest in the partnership, HMRC takes a rights-based approach. Further uncertainties also arise, the details of which are beyond the scope of this article. For example, where a new partner joins and an existing partner retires and withdraws capital, HMRC's view is that a charge only arises when the withdrawal of capital is funded by arrangements which are dependant upon the introduction of a new partner as otherwise no consideration is treated as given. However, there is again no basis in the legislation for this view. HMRC's views in this area are generally favourable to taxpayers, but the problem is that it is difficult to ascertain where the taxpayer stands as a matter of strict law and – naturally – this makes advising difficult.

It is now proposed that the charge on the transfer of an interest in a partnership will be restricted to partnerships whose main activity is either investing or

dealing in land. Trading partnerships which do not deal in land will not be subject to this charge. This change is helpful to taxpayers, but it does nothing to alleviate the uncertainty for those who remain within the charge.

## Other Matters

This article is chiefly concerned with the three main charges to tax which arise under the partnerships regime. However, the regime also contains other rules which should not be overlooked. The general rule is that the SDLT reliefs apply to the partnerships regime. Perhaps the most important point to be aware of here is that in order to claim group relief on a land transfer, all the partners will need to be group companies: there is no ability to claim a proportion of the relief. Finally, the partnerships regime contains anti-avoidance rules to prevent the regime being used for the purposes of saving SDLT. As a regime which prescribes very precise results and is less amenable to broad-brush interpretations, the partnerships regime is potentially a fertile ground for tax planning, and the anti-avoidance rules are certain to be scrutinised in order to see if there is a way around them.

## Conclusion

In summary, perhaps the key points to take away from this article are:

(1) The SDLT treatment of partnerships is a very complicated and unsatisfactory area, which requires caution;

(2) HMRC takes some controversial views which have no basis in the current legislation (although many of these are favourable to taxpayers);

(3) Creating a partnership may result in an SDLT charge;

(4) SDLT is still a potential issue even though, as a matter of general law, land is held outside the partnership;

(5) There is considerable uncertainty as to the scope of many of the key concepts including "actual consideration", "partnership property" and the issue of when consideration is given for the transfer of an interest in a partnership; and

(6) Although welcome reforms are proposed from Royal Assent of the FA 2006, which will remove the charge on actual consideration and confine the charge on the transfer of an interest in a partnership to partnerships whose main activity is investing or dealing in land, many problems will remain.

A real practical problem which advisers face is that often the complexity of the analysis required to determine what should be a straightforward tax charge is totally disproportionate to the tax at stake. This should be a

serious concern to taxpayers, their advisers and to HMRC.

## Further Reading

Schedule 15 FA 2003

Schedule 24 Finance (No. 2) Bill 2006 (and explanatory notes).

HMRC's draft partnerships manual, available at www.hmrc.gov.uk/so/pftmanual.htm

"Stamp Duty Land Tax" (2nd edition) Michael Thomas (Cambridge University Press)

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