Professional goodwill

Some welcome clarity of the tax treatment of goodwill of a professional practice.

The recent case of *R Villar v HMRC* [2019] UKFTT 117 (TC) examined the tax implications of the sale of goodwill by a professional person, and it is a helpful clarification of the law in this area.

Mr Villar had a successful medical practice and he sold the business as a going concern to Spire Healthcare Diagnostics Ltd for £1m. Mr Villar said that the sale gave rise to a capital gain. However, HMRC argued that the payment was chargeable to income tax.

An important part of HMRC's argument was that the payment was mainly attributable to goodwill, which it said could not be transferred to Spire because the goodwill was personal to Mr Villar.

HMRC also argued that this was not the disposal of a business because there was no business to dispose of; this was really a payment to Mr Villar for the exploitation of his professional skills for a future flow of income. In other words, it was an arrangement for Mr Villar to obtain money in capital form (taxed at only 10% having regard to entrepreneurs' relief), and not as income which would have given rise to rather more tax.

However, when anybody buys a business, they are buying an income flow. They buy the business because it makes profits and that is what provides the capital value. The purchaser may be able to exploit synergies with his own business or may feel that he has something to add to the business which will increase the profitability. On the sale, the vendor gives up the future profits which are subsequently received by the purchaser – but that does not mean every sale is therefore a sale of future income which is chargeable to income tax on the vendor. The sale of a business gives rise to a capital receipt chargeable to capital gains tax.

Mr Villar certainly believed that he had a business capable of sale – and he sold it. The expert valuers who valued the business thought so too – and they valued it. And Spire obviously thought Mr Villar had a business capable of being bought because it paid £1m for it.

The tribunal did not take long to conclude that the sale by Mr Villar was a sale of his business and that the amount received was capital.

However, that was not the end of the story. HMRC then argued that even if the payment was capital, it should be taxed as income because of ITA 2007 s 773 which charges income tax on any capital sum received to exploit the earning capacity of an individual in an occupation.

The tribunal observed that there was no intention or obligation on Mr Villar to continue to work in the business. Accordingly, it was difficult to conclude that the purchaser was exploiting Mr Villar's earning capacity. In reality (and in fact) Spire was exploiting the practice (and the goodwill) that Mr Villar had sold to it.

The second condition for s 773 to apply is that one of the main objects of the arrangements was the avoidance of a liability to income tax. HMRC said that if Mr Villar had continued to receive the profits of his practice, they would have been chargeable to income tax; whereas by selling the practice, he received £1m which gave rise to a capital gain. That was a substantial tax advantage; indeed, it saved the whole of the income tax.

The tribunal found that there was no intention to avoid or reduce income tax, and it saw no evidence that income tax had been considered at all. Having regard to the huge tax saving involved, this view was no doubt welcomed by Mr Villar, but it did not matter because the tribunal found that s 773 had no application in any event. ■

Peter Vaines, barrister, Field Court Tax Chambers (pv@fieldtax.com)

Valuing management charges for VAT purposes

Is the arm's length principle about to enfold VAT?

The UK First-tier Tribunal is preparing to hear an appeal that will explore the interaction between valuation rules for VAT and transfer pricing purposes.

The *Jupiter Asset Management* case concerns a management charge between members of a corporate group, which HMRC argued had been undervalued for VAT purposes. The tribunal is expected to consider whether the arm's length principle, and the OECD transfer pricing guidelines thereon, are an appropriate means to determine open market value of a management charge for VAT purposes.

If the tribunal finds that to be the case, corporate groups that use cost as a basis for valuing such intercompany charges may be required to charge a higher amount. Where the recipient of the charge is not entitled to recover all the VAT it incurs on its costs, for example because it is partly exempt for VAT purposes, this may increase its irrecoverable VAT burden.

In a procedural hearing, the tribunal judge noted that there is currently no case law from the Court of Justice of the European Union (CJEU) on the relationship between the Principal VAT Directive and the OECD guidelines, so there was a possibility that questions on this point may be referred to the CJEU. Uncertainty over the precise terms of the UK's withdrawal from the EU may mean this appeal will be considered in the UK courts rather than the CJEU, but this could still lead to some changes in how management charges, and possibly other income stream recharges, are valued for VAT purposes.

While initially designed for valuing intercompany transactions to determine profits for corporate income tax purposes, the arm's length principle and OECD guidelines are increasingly referred to in other valuation exercises. The tribunal's findings on the extent to which they might be used in VAT disputes could extend their influence yet further, into indirect taxes.

Businesses that make or receive similar management charges should therefore watch out for the tribunal's decision on this point. ■

Anton Hume, partner, BDO (anton.hume@bdo.co.uk)

Grain silo is plant

Good news for farmers.

In *S May and others v HMRC* [2019] UKFTT 32, the whole cost of a new grain facility (silo) was accepted as plant as opposed to a storage barn by the First-tier Tribunal (FTT). HMRC's *Capital Allowances Manual* states: 'Treat a grain silo as plant where, together with its attendant machinery, it performs a function in distributing the grain so that acts as a transit silo rather than a warehouse' (CA22050).

Mr May is an arable farmer, growing cereal crops. He built a silo to dry his grain and claimed plant and machinery allowances (PMAs) for the whole cost of the silo. HMRC accepted that the ventilation equipment in Mr May's grain silo qualified for PMAs, but such apparatus amounted to only approximately one-fifth of the total cost of the silo.

The ventilation equipment contained within the silo dried the grain and included an air inlet vent on one side of the building with an extractor fan opposite to draw air across. When the outside air was drier than the grain, a central control switched on the pedestal blowers, and the drawn-up air removed moisture from the grain as part of the drying process.

HMRC disputed the silo's active function in the business and took the view that it should be treated as a barn or shed. Mr May argued that all the components

including the structure were integral to the function and such a view was accepted by the tribunal. In arriving at its position, the FTT considered two points:

- whether this facility is a 'silo provided for temporary storage' within the meaning of list C in CAA 2001 s 23; and
- whether this facility is 'plant or machinery' within the meaning of CAA 2001 s 11(4)(a).

The tribunal was of the view that Mr May's structure constituted business apparatus on which full capital allowances can be claimed. The current legislation states that expenditure on a 'building' (CAA 2001 s 21) or a 'structure' (CAA 2001 s 22) cannot qualify for PMAs.

The FTT not only found that the drying process required moveable items within Mr May's silo facility, but also the structure of the building was integral to the success of the process. Mr May's silo was specifically designed, built, and used to store, condition, and maintain grain through a continuing process of aeration. The tribunal noted that the cost of the silo was much more than a general-purpose agricultural building, and its features made it unsuitable for other agricultural uses. The tribunal was satisfied that it was a silo within the meaning of list C item 28.

The tribunal considered that the grain could not be stored in the silo as it could not be kept for much longer than nine or ten months without deteriorating and it was only held until it could be sold. As Mr May's business was growing and selling grain and not storing it, then Mr May holding his stock was just part of the activity of selling the grain. The tribunal concluded that the silo facility dried and conditioned grain; and that all its components, including the structure, were integral to this operation and constituted business apparatus. Therefore, the tribunal considered that the cost of the silo facility was eligible for plant capital allowances in full even though it was a 'building', provided it was possible to prove that the structure of the building was integral to its successful performance – which it was, and so Mr May won his appeal. ■

Julie Butler, Butler & Co (j.butler@butler-co.co.uk)

Mydibel and tax adjustments

The wider application of Sch 10 'clawback' provisions to lease back financing deals.

As you read this piece the UK may already have left the EU, though it hadn't at the time of writing. The accepted position is that all CJEU decisions pre-dating that departure date become binding decisions at Supreme Court level. We therefore need to pay heed to the dates of decisions. The CJEU's decision in *Mydibel* (Case C-201/18) makes the cut, so to speak, and would have done so by two days even had the UK left as planned on 29 March. It is therefore binding precedent.

And it has something direct to tell us about the application of the capital goods scheme (CGS) to cases where a fully taxable business creates property, and finances it through a lease and lease back scheme in which the intermediate party is a bank, and where the charges are effectively the same as would apply in a mortgage scenario. Reducing the decision to its outcome, the CJEU decided that this did not change the business's fully taxable use of the building despite the intervening lease activities mentioned above being exempt.

Given the basis of VAT as a tax where each link in the chain of supplies is separate, as per the well-known *BLP* case (Case C-4/94), this could be thought surprising. It appears that the court was not happy to suspend the reality of a continuing taxable use to indulge in tax law quibbles over what was essentially a refinancing package (and no more). The key to this was that the first lease to the bank was subject inextricably to the return lease granted by the bank, such that the bank had no occupation rights whatever, and never would have. This could not be viewed as two separate supplies, but was one action (and the court even suggested it was a single supply, though of what and to whom seems a tricky point if that is to be accepted).

However, my main concern is not the impact on the CGS position, but the casting of it wider to the impact on Sch 10 'clawback' provisions where the zero rating of an original residential or charitable building is effectively nullified by a sale and leaseback, if one accepts the Court of Session's decision in *Balhousie* [2019] CSIH 7.

This is a different provision to CGS. And Balhousie sold the properties outright to the lender and took back a lease, which didn't happen in *Mydibel*. It also appears that the lease/leaseback transaction in *Mydibel* occurred before the construction costs were fully incurred, whereas in *Balhousie* there was (it appeared) a completed property that was then sold for a leaseback purpose. HMRC will say that all these factors (and probably others) distance *Balhousie* from *Mydibel*.

But I would not agree. The point in *Mydibel* – the nugget at the centre of it – is that a transaction which comprises two legs of a property grant effected solely to finance operations and where there is no real change of use, should not engage an adjustment mechanism, the sole purpose of which is to give a more accurate attribution through adjustment of the original tax treatment. In that aspect, the clawback in Sch 10 is the same as the CGS, so there is no reason to treat them differently.

If one lifts one's eyes from the question of distinguishing facts in these cases, one sees the principle, which is that there should be no adjustment arising from lease back financing deals. For that reason, I think this strongly implies that *Balhousie* was wrongly decided by the Court of Session. ■

Graham Elliott, City & Cambridge Consultancy Ltd (graham@cityandcambridgeconsultancy.com)

Bruce Sutherland & Co
Share valuation specialists
"The estimation of the value of a share in a company whose shares cannot be bought and sold in the open market, and with regard to which there have not been any sales on ordinary terms, is obviously one of difficulty."
Lord Fleming in Salvesen's Trustees v IRC [1930]
B W Sutherland CBE FCA FTII
Miss J A Nelder BA FCA FTII
David Bowes FTII MAE EWI
Moreton House, Moreton-in-Marsh, Gloucestershire GL56 0LH
Tel: 01608 651091 Fax: 01608 651973 DX 11484 Moreton in Marsh
bruce.sutherland@bruce-sutherland.com jenny.nelder@bruce-sutherland.com david.bowes@bruce-sutherland.com