UK Tax Bulletin

October 2020

FIELD COURT TAX CHAMBERS

FIELD COURT TAX CHAMBERS

Contents October 2020

FIELD COURT TAX CHAMBERS

Latest Rates of Inflation and Interest

The following are the latest rates:

Current Rates	
Retail Price Index: August 2020	293.3
September 2020	294.3
Inflation Rate: August 2020	0.5%
September 2020	1.1%
Indexation factor from March 1982: Frozen at December 2017	2.501

Interest on overdue tax

Interest on all unpaid tax is charged at the same rate.

The formula is Bank base rate plus 2.5% which gives a rate of 2.6% from 9th April 2020.

There is one exception: Quarterly instalments of corporation tax bear interest at only 1.25% from 23rd March 2020

Repayment supplement

Interest on overpaid tax is payable at the same rate from 21st August 2018

The formula is Bank base rate minus 1% but with an overriding minimum of 0.5% which applies at the present time.

Official rate of interest

To 6th April 2015: 3.25%

To 6th April 2017: 3%

To 6th April 2017: 2.5%

From 6th April 2020 2.25%

Goodwill

The existence and value of goodwill is a subject which crops up a good deal in connection with tax – one example being on the transfer of goodwill to a company giving rise to a charge to capital gains tax, possibly ameliorated by a claim to Entrepreneurs' Relief. The relief no longer applies on transfers of goodwill to a connected company – but the underlying capital gains tax implications continue to exist and can still be advantageous.

I have mentioned (many times) that the meaning, existence and value of goodwill is often a matter of dispute with HMRC – examples being the cases of *Richard Villar v HMRC TC 6893* and *Leeds Cricket Football and Athletic Company Limited v HMRC TC 7362.*

It was therefore interesting to read the recent Court of Appeal judgment in *Primus International Holding Company v Triumph Controls UK Limited (2020) EWCA Civ 1228*. This was not a tax case but a commercial dispute about a possible loss of goodwill arising on a sale of a company and it contained a detailed analysis by the Court of Appeal on the meaning of goodwill. The Court described goodwill as:

> "a proprietary right representing the reputation, good name and connections of a business".

The Court also described the ordinary legal meaning of goodwill as "the good name and public recognition of the business concerned" which would seem to be exactly the same thing.

For accounting purposes, goodwill is a broader concept essentially being the difference between the value of something and the price you paid for it; this may be reflected in the accounts as Goodwill. So if the value of the asset goes down it can be said that there has been a loss of goodwill.

This was the essential point of the case. However, the Court of Appeal held that the ordinary commercial meaning is to be preferred over the technical accounting meaning, for numerous reasons.

This may not be particularly earth shattering but it is helpful to have the confirmation of the Court of Appeal regarding the proper meaning of goodwill which will no doubt apply equally for tax purposes.

Duality of Purpose

Everybody knows that when a tax deduction is claimed for an expense, it will not be allowable if there is a duality of purpose – that is to say the expenditure was not "incurred wholly and exclusively for the purposes of the trade". These words are now found in Section 34 ITTOIA 2005 and must be the best known words in the whole of the tax legislation. They have also been the subject of the most amazing amount of litigation.

The most celebrated – and the most authoritative - case is that of *Mallalieu v Drummond (1983) 57 TC 330* in which the House of Lords provided the definitive legal analysis.

Most people will be familiar with the facts. Miss Mallalieu (as she then was) practised as a barrister and it was necessary for her to adhere to the requirements of the Bar Council regarding dress in Court. She therefore purchased white blouses and black clothing (of unobtrusive nature, long sleeved and high to the neck etc) for this purpose. She did not find such clothing suitable for her personal use and she did not wear these clothes otherwise than for work. The Commissioners found as a fact that her sole motive in incurring the expenditure was to satisfy the requirements of her profession.

You might have thought that this was game set and match. This was the legal test and on the facts found by the Commissioners, she satisfied the test.

Not so fast, Kimo Sabe; best not to jump to conclusions here.

In due course, the judgment of the House of Lords was that although her sole object in incurring the expenditure was for the purposes of her profession, that was not enough because she had another purpose – a subconscious motive. This subconscious motive was the provision of clothing to satisfy her needs as a human being. This was a personal purpose. There was therefore a duality of purpose and the expenditure was disallowed.

With these principles in mind, it was interesting to read the recent Tribunal case of *Osborne v HMRC TC 7851* which involved a deep-sea diver and a claim for expenditure on fitness training.

HMRC unsurprisingly argued that fitness is a human need in the same way as food, shelter or clothing, and that there is an inescapable duality of purpose in fitness training.

However, the Tribunal found that Mr Osborne's sole purpose in incurring the expenditure was to enable him to work as a saturation diver. The physical necessities of saturation diving dictated his training methods, their duration and location.

(It is difficult to distinguish this reasoning from that which applied to Miss Mallalieu's Court dress. She was obliged as a matter of professional necessity to wear the particular clothing which she purchased for the sole purpose of her work).

The Tribunal also said that Mr Osborne would not train for 2 or 3 hours a day if he did not need to do so for the purpose of working as a saturation diver. His fitness regime was designed to continue working in his occupation far removed from his personal physical needs. (Again, the same could be said about Miss Mallalieu's Court dress. This too was far removed from her personal needs).

The Tribunal held that "it is not reasonable to infer that in his circumstances Mr Osborne undertakes this level of training because of a subconscious motive of keeping fit as a human being".

It might be thought that keeping fit was part of his needs as a human being – although not perhaps to the same level. But that just makes it a matter of degree. And if there is any degree of human need (consciously or otherwise) that would seem to be enough to disqualify the expenditure.

Anyway, for the above reasons, the Tribunal decided that Mr Osborne was entitled to a deduction for his expenditure.

This is a very welcome decision bringing a degree of practical flexibility to the meaning of Section 34. The test in *Mallalieu v Drummond* is very strict and is never understood by clients who invariably feel that if you spend money with the sole purpose of your trade, then it is only right that it should be allowable.

It may be remembered that a similar conclusion was reached by the Tribunal in *Gemma Daniels [2018] UKFTT 462* whose expenditure on clothing was also allowed. Her circumstances were a little different. She was a professional pole dancer and she danced without any clothes on at all (although the judgment does indicate that she kept her shoes on), so the need for warmth and decency was conspicuously absent. It was not at all clear what part of her work she needed the clothes for, if it was not to wear when she was dancing, but maybe we should not dwell too much on these matters.

It is to be hoped that the case of *Osborne* represents a new benchmark which will result in a more flexible test for the allowability of expenditure – but I fear it is going to be a hard struggle. I cannot imagine HMRC will give up their totemic success in *Mallalieu v Drummond* which they may feel would open the floodgates for many more claims for trading expenditure – but we shall see.

Principal Private Residence

The only or main residence relief for capital gains tax in Section 222 TCGA 1992 is also well-known (and equally misunderstood by taxpayers). Section 222 provides a capital gains tax exemption for a gain made on a dwelling house which is or has been the taxpayer's main residence, together with any land which they have for their own occupation and enjoyment with that residence as its garden or grounds.

The permitted area of land qualifying for the exemption (inclusive of the size of the house) is 0.5 of a hectare. However, Section 222(3) provides a relaxation to this limit as follows:

> "Where the area required for the reasonable enjoyment of the dwelling house … as a residence, having regard to the size and character of the dwelling house is larger than 0.5 of a hectare, that larger area shall be the permitted area".

This is an objective test and it relates not to the particular requirements of the occupier, but to the property itself: *Longson v Baker [2001] STC 6.*

The reference to whether the larger area is required does not mean merely that the occupiers like it, or they would miss it if it were not there, or that the house may be less valuable if it were not there. It means that without it, there would be such

substantial deprivation of amenities or convenience that a real injury would be done to the property owner: *re Payne's Application [1938] 2All ER 163.*

In the recent case of *Phillips v HMRC TC 7859*, Mr and Mrs Phillips had a main residence consisting of a house with 5 bedrooms, a 3-car garage, an adjoining cottage, a swimming pool and grounds covering nearly 1 hectare.

The property had been marketed with three quarters of an acre (because Mr and Mrs Phillips wished to retain the remainder of the garden and the adjoining paddock for its development potential). However, none of the potential purchasers would proceed without being able to buy the whole of the garden and in due course, the whole property was sold to a developer at a substantial gain.

HMRC sought to restrict the exemption to half a hectare and to exclude any larger area on the grounds that the area of land which was *required* did not mean an area that a purchaser would prefer. It may not be unreasonable for a purchaser to want more land but that is not the test. HMRC said that comparable properties had smaller grounds which demonstrated that the dwelling house in this case could be enjoyed perfectly well with the reduced area of land.

However, the Tribunal decided that the whole of the land was required for the reasonable enjoyment of this dwelling house and therefore qualified for the relief. Their reasoning was that context is everything – including the location of the property. It may be the case that the purchaser of a property in a suburban location would not expect a garden or grounds of this size, but they would do so in a more rural location like in this case.

It was also relevant that the agent indicated that when Mr and Mrs Phillips originally bought the property, all of the prospective purchasers had insisted on buying the whole of the garden and nobody was willing to purchase the property with only part of the garden. This indicated that the whole of the grounds was a requirement and more than merely a preference.

It is interesting that the decision was based mainly on the evidence of purchasers at both the date of acquisition and sale as well as comparisons with other properties – despite the objective nature of the test for this particular property. The nature of the surrounding land even if it is merely for the view, or the assurance that the view will not be obscured by other buildings, are factors which might also be taken into consideration.

PPR: FA 2020 Changes

While on the subject of principal private residences, I would mention that apart from the reduction in the 18 month period of grace for disposing of the main residence to only 9 months, the Finance Act 2020 has enacted two Extra Statutory Concessions. That is of course welcome (although the certainty of a statutory right is not always advantageous as it lacks the inherent flexibility of a concession)

New subsection 222(5A) TCGA 1992 replaces ESC D21 and allows the taxpayer an unlimited period to nominate which of two residences should be treated as his main residence provided that one of them was of negligible value – such as a rented flat;. It has been suggested that few taxpayers realise that in such circumstances a nomination may be necessary – or at least desirable.

New section 223ZA replaces ESC D49 and provides for a "moving-in time" of 24 months from the beginning of the period of ownership, so that the property can be treated as the main residence from the date of acquisition.

This resolves the conflict which arose last year over the application of ESC D49 (or more accurately the Tribunal's jurisdiction) where the FTT came to opposite conclusions in the cases of *White v HMRC TC 7434* and *McHugh v HMRC TC* 6605

This statutory relief does not apply automatically but only if works of construction, renovation, redecoration or alteration are completed during the period - or alternatively if the taxpayer had disposed of a previous property during this 24 month period which had been his main residence immediately before the disposal.

Entrepreneurs' Relief

Changing the name of Entrepreneurs Relief to Business Asset Disposal Relief has not made any of the arguments easier. Mr Holland-Bosworth is the latest person to fall foul of the technical provisions of the relief*: G Holland-Bosworth v HMRC TC 7811.*

Mr Holland-Bosworth had some B ordinary shares representing 5% of the ordinary share capital of the company but unfortunately they had no votes. There were various arguments that the shares were thought to have votes or that they would have been given votes without demur, but the fact was that the Articles expressly said that they did not – and having 5% of the voting power is a key condition for the relief.

It was necessary to consider what sort of voting rights are relevant for the purposes of the relief under section 169S(3)(b) TCGA 1992. The Tribunal made it clear that they have to be voting rights which are exercisable in a general meeting of the company. Votes which are exercisable only in a meeting of a particular class of shares are not sufficient to meet this test.

Peter Vaines
Field Court Tax Chambers
31st October 2020

FIELD COURT TAX CHAMBERS

Contact

Peter Vaines
Field Court Tax Chambers
3 Field Court
Gray's Inn
London WC1R 5EP
Tel: 020 3693 3700
pv@fieldtax.com
www.fieldtax.com

Important Note