FIELD COURT TAX CHAMBERS

FCTC DIGEST

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EDITORIAL

Patrick Soares

Welcome to the Post-Domicile Changes issue of the Digest. The dust is settling and as problems (and gaps) come to light under the new regime, these will be covered in future issues of the Digest

The first article by the editor looks at the position of the taxpayer who can afford to buy some land but needs his family company to build the house of his dreams on it. This article looks at his options and a couple of **employment income** traps to look out for.

The second article is by **Patrick Way KC,** and deals with the position if a contribution is made to a company by way of a gift. There is a **CGT catastrophic loss in base cost**. How can this be avoided? - read the article!

The third article is by **Peter Vaines**. He takes the **GAAR** head on and considers it has lost its way. He refers to Graham Aaronson's warning:

> "Although clearly intended to apply only to egregious, or very aggressive, tax avoidance schemes, it was thought likely that HMRC may seek to apply the GAAR more widely".

The GAAR has evolved in exactly that way in Peter Vaines' opinion.

The fourth article is by **Dilpreet Dhanoa.** She looks at the world of **arbitration** – domestic, European and international – as a means of resolving tax disputes. She points to the ease of international arbitration in complex cross-border disputes and the bars to similar domestic arbitration.

The fifth article is by **Riya Bhatt** and brings practitioners up-to-date on how to **incorporate a property letting business** without SDLT and CGT charges. It is a must read for those planning such an incorporation.

The sixth article is by **David Tipping**. In the Supreme Court case of the *Royal Bank of Canada v HMRC* [2025] UKSC 3 (concerning the UK Canadian Convention) David has detected that "the Supreme Court may have begun to lay the groundwork for (yet another) quiet revolution in its approach to the

Ramsay principle." For **Ramsay** *aficionados* this is a must read.

The seventh and final article is by **Alex Spencer** and has been tailor-made for the summer holidays. He deals with the quirk in the **VAT legislation** which means that the purchase of a newly built holiday home is subject to VAT at the standard rate, but building one from scratch is not. It does not sound logical to me but Alex will explain.

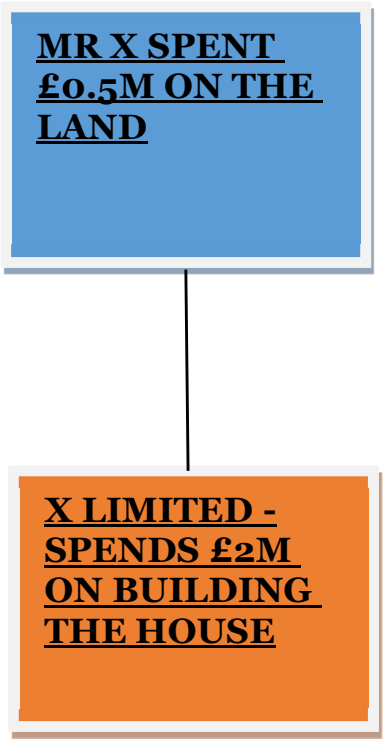
Patrick C Soares

FCTC

I HAVE ENOUGH MONEY TO BUY THE LAND BUT I NEED MY COMPANY'S MONEY TO BUILD THE HOUSE OF MY DREAMS ON IT – WHAT ARE THE TAX CONSIDERATIONS?

Patrick C Soares

Mr X has enough money to buy the land for £0.5m but needs his family company to build the house of his dreams on it for £2m; how should he go about matters? Let us say after the building works have been completed because of a down turn in the market the property – the land and the building – are only worth £1m – should he buy it or live in it? There are two "expense" traps to look out for.



Question: should Mr X live in the house or should he buy the company's interest?

Scenario One - Leave the property interest of the company in the company and live in the house

The two charges would be

a. the ATED (annual tax on enveloped dwellings) and

b. the BIK (benefit in kind) provisions.

Land law

The building will have become annexed to the land. It is the ultimate fixture.

The editor would take the view that the land and building have become owned in the proportions based on contributions, and the property will be held beneficially as tenants in common.

If the property is worth £1 m when he moves in the taxpayer's share will be worth approx. £200,000 and the company's £800,000.

Annual Tax on Enveloped Dwellings (ATED)

The charge depends on the value of the property and revaluations in the future will also be required. The company on present rates has to pay annually £4,450 (see FA 2015 s99 and HMRC ATED Guidance 6 November 2024).

Benefit in Kind

The taxpayer will pay a benefit in kind charge annually.

There is an argument that as the taxpayer is a tenant in common he has the right to enjoy the property regardless of the company's position so there should be no BIK charge. HMRC will be expected to argue to the contrary.

In EIM11414 they state:

> *There are arguments to support a benefit charge within Part 3 Chapter 5 ITEPA 2003 in these cases and the strength of those arguments will depend on the facts of the case. (This content has been*

withheld because of exemptions in the Freedom of Information Act 2000)

Clearly HMRC should agree to a discount of 1/5th.

The taxpayer pays income tax (employment income) on the cash equivalent of the benefit calculated under ITEPA 2003 s106.

The annual charge on the taxpayer is equal to the Annual Value (AV) + an amount equal to the official rate of interest (ORI) on the £2m laid out by the company less £75,000. The formula is thus:

AV+ (ORI x (£2M-£75,000))

The annual value equates to the old rating system and is not a big figure (Whitman & Sherry on Income Tax 15.017). The official rate from 6 April 2025 is 3.75%.

This is not an attractive proposition.

Scenario two - Purchase the company's interest when the house is completed

If he personally decided to purchase the property when it is completed (he owns a tenancy in common

interest and he buys the company's interest) what would the tax implications be?

If he bought the company's share he would have to find (say) £800,000.

There will be a SDLT charge,

The BIK provisions require special focus.

The general rule is one values the benefit provided to the employee (Wilkins v Rogerson 39 TC 344). This is a charge under general principles. ITEPA 2003 s62 taxes a money receipt or something which can be converted into money. In our case, this is £800,000 approx as the taxpayer can onward sell the property share for that amount. If he thus pays £800,000, he will on the face of it receive no benefit (see EIM08001).

However, there is an additional rule which applies to "employment related benefits" (these are benefits not dealt with under other benefit heads: see Simon's Taxes E4.662); if this code applies the charge is based on the cost to the employer (£2m in our case).

ITEPA 2003 s203 states:

> S203 Cash equivalent of benefit treated as earnings
>
> (1) The cash equivalent of an employment-related benefit is to be treated as earnings from the employment for the tax year in which it is provided.
>
> (2) The cash equivalent of an employment-related benefit is the cost of the benefit.

And s204 states:

> 204 Cost of the benefit: basic rule
>
> The cost of an employment-related benefit is the expense incurred in or in connection with the provision of the benefit (including a proper proportion of any expense relating partly to provision of the benefit and partly to other matters).

This on the face of it is a problem.

The answer to this problem is found in ITEPA 2003 s206 which reads thus:

206 Cost of the benefit: transfer of used or depreciated asset

(1) The cost of an employment-related benefit is determined in accordance with this section if—

(a) the benefit consists in the transfer of an asset, and

(b) the asset has been used, or has depreciated, since the person transferring the asset ("the transferor") acquired or produced it.

(2) The cost of the benefit is the market value of the asset at the time of the transfer.

(3) .....

Thus if the purchase takes place when the property is worth £800,000 and £2m has been spent by the company the taxpayer can be taxed on the £2m minus what he pays the company *unless* he can show the property has depreciated in value because of

market conditions over the period of the company's ownership.

What does depreciation in value mean? Contrast these examples.

Example

X Ltd buys land for £1m and puts up a building in part for £3m. At that point it is worth £4m but due to subsequent market conditions it goes down in value (depreciates in value) and becomes worth £1,5m. If the director bought the property for £1.5m he will not be taxed on £2,5m.

Example

X Ltd buys land for £1m and puts up a building in part for £3m. At that point it is worth £1.5m. There has been no change in market conditions and thus no depreciation in value. If the director bought the property for £1.5m he will be taxed on £2.5m.

CONCLUSION

The best scenario is to buy the company's property interest subject to the valuer being able to confirm the depreciation point.

CAPITAL CONTRIBUTIONS TO COMPANIES – MAKE SURE YOU GET A DEDUCTION IN THE CAPITAL GAINS COMPUTATION

Patrick Way KC

Speed read

I own shares in a company and I then make a capital contribution. What is the problem?

There is no acquisition cost for capital gains purposes.

Why not?

You have not bought an asset and you have not enhanced the state or nature of the existing shares.

What is the statutory authority in point?

TCGA 1992 s.38.

What is the relevant case law?

Fenston Will Trusts

What is the way round this?

Issue at least one share "for" the contribution.

Why does that work?

Because of the pooling rules at TCGA 1992 s.104.

Is one share really enough?

Yes. But for the sake of the "optics" I would issue more even though not strictly necessary.

Capital contributions

As a matter of UK law it is not (technically speaking) possible to make a capital contribution. However, the company law provisions of some foreign jurisdictions, notably the USA, do provide for the making of capital contributions to companies. In these circumstances such a capital contribution is a contribution to the equity capital of a company, but is not made in exchange for shares issued to the contributor and it does not constitute a separate asset in its own right.

Many years ago I was asked to advise in a situation where a special purpose acquisition vehicle had been set up, under US law, with $2 and then subsequently a significant amount of money (approximately £1bn.) had been added to that acquisition vehicle, by way of a capital contribution, but no new shares had been issued in respect of that contribution.

Subsequently, it was desired to dispose of the acquisition vehicle in circumstances where there was a disposal for UK tax purposes. However, because the initial share capital was in respect of $2 only and the later capital contribution was not matched by a fresh issue of shares, the "base cost" of the shares in the acquisition vehicle was not the billion pounds that it should have been; instead it was simply $2. The capital contribution had not increased the base cost under the relevant legislation of the issued share capital in the acquisition vehicle.

The reason for this was simply that the relevant provisions for obtaining "base cost" are found in TCGA 1992 s.38(1) and for a capital contribution to have satisfied the requirements of those provisions the capital contribution would have had to have been spent on the purchase of an asset, such as an issue of shares, or else to have represented enhancement expenditure on the existing shares. Specifically, the relevant legislation reads as follows:-

> "**38 Acquisition and disposal costs etc**
>
> (1) … the sums allowable as a deduction from the consideration in the

computation of the gain accruing to a person on the disposal of an asset shall be restricted to –

(a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf **wholly and exclusively for the acquisition of the asset**, together with the incidental costs to him of the acquisition or, if the asset was not acquired by him, any expenditure wholly and exclusively incurred by him in providing the asset,

(b) the amount of any expenditure wholly and exclusively incurred on the asset by him or on his behalf for the purpose of enhancing the value of the asset, **being expenditure reflected in the state or nature of the asset at the time of the disposal**, and any expenditure wholly and exclusively incurred by him in establishing, preserving or

defending his title to, or to a right over the asset,

(c) the incidental costs to him of making the disposal."

It can be seen that where a capital contribution is involved no consideration is given, of course, for the acquisition of an asset because, of course, no asset is bought: there is just a pure contribution without a corresponding issue of one or more new shares. (So s.38(1)(a) is not satisfied.)

Accordingly, the remaining question is whether it can be argued that, in effect, the capital contribution is representative of enhancement expenditure (in respect of the shares already in issue) which should be added to the so-called base cost (s.38(1)(b)).

Unfortunately, the state or nature of the issued share capital is not affected by the capital contribution. So, the capital contribution is not qualifying enhancement expenditure.

The case of *The Trustees of the FD Fenston Will Trusts v Revenue & Customs* (SpC 589/07), being at first instance, is "persuasive but not

binding authority" (so it operates as guidance) for saying that a capital contribution which is not made as part of the terms for the issue of shares is not an allowable deduction within TCGA 1992 s.38 to be taken into account when a subsequent disposal occurs.

In that case, the trustees acquired the entire issued share capital of a Delaware company for $1,000. Subsequently, significant amounts of money were paid by the trustees to the company by way of capital contributions. No new shares were issued.

Unfortunately, the company later became worthless and the trustees then sold the entire issued share capital for $1.

At that time, the trustees then sought to obtain a tax loss by reference to their initial purchase price of $1,000 together with the very significant amounts which had been transferred in by way of capital contributions.

It was held in the Special Commissioners, however, that the requirements of TCGA 1992 s.38 were not met: the base cost was $1,000, and no more.

The capital contributions were ignored for two reasons.

In the first place no asset had been acquired, so s.38(1)(a) was not engaged.

And in the second place, the capital contributions could not be said to amount to "enhancement expenditure" under s.38(1)(b) in respect of the issued share capital. After all, the value of the contributions could not be said to be reflected in the state or nature of the asset itself being the relevant shares which had been acquired at the outset.

At the hearing the trustees argued that the value of the issued shares in the Delaware company was significantly increased, let us say, by the value of the contributions, and therefore the state or nature of those shares reflected the value of the contributions themselves. This argument failed, unfortunately.

As a separate point and to demonstrate the unfairness of the position it was pointed out by the trustees that under the pooling provisions within TCGA 1992 s.104 had even one single share been issued in exchange for the very

significant capital contributions, then that new share would have been added to the holding of the original shares. The consequence of this pooling would have been that the total amounts paid by the trustees (being the initial acquisition expenditure and the later capital contributions) would have been added to the acquisition cost of the shares.

Separately, it was observed by the trustees in the hearing that, had the process involving the contributions fallen into the reorganisation rules within TCGA 1992 s.128 (and had just one share been issued), the value of those contributions would have been reflected in a corresponding increase in the base cost of the shares which had been acquired initially and which were disposed of when the company was sold.

However, neither of these observations, as to the unfairness of the trustees' position coupled with the fact that just one issue would have rectified matters, "cut the mustard" with the Special Commissioners (Stephen Oliver and Nicholas Aleksander).

This is a trap which I have come across before as mentioned and it typically arises where foreign companies are involved and foreign advisers are not aware of the way in which capital contributions are treated in the United Kingdom for tax purposes.

Whenever I have this sort of situation I always ensure that at least one share is issued in exchange for the "capital contribution" to take advantage of the provisions of TCGA 1992 s.104 (the pooling provisions).

Indeed, recognising the somewhat sceptical views of some modern tax judges I go further and recommend that, rather than one single share being issued in exchange for a contribution, a significant number of shares should be issued. This is so that the position "feels right". Strictly speaking, this is not necessary but I always advise taking such a course of action so that (potentially) judges feel more comfortable. By this I mean that some judges would find it difficult to "believe" that an issue of a single share could give, say, an

additional £1bn. of acquisition cost. So I would issue 10,000 shares, for example.

I recently had this situation to consider. It involved a reorganisation of a major group where there were Bahamas-incorporated companies. My information was that capital contributions could be made into the Bahamas companies without there being adverse tax considerations in respect of those contributions without the need for a share issue.

For the reasons which are mentioned in this article, however, I advised, nevertheless, that there should be an issue of fresh shares in respect of the capital contributions. This, of course, was to ensure that the capital contributions (so called) would be reflected in the s.38 acquisition cost just in case a future disposal had UK tax implications.

For example, if there were to be a gain in the future, in respect of the Bahamas-incorporated companies, that gain might become visited upon UK persons pursuant to the provisions of, say, TCGA 1992 ss.3, 86 or 87. So having the

maximum amount of allowable expenditure could prove to be very important.

Going back to the situation mentioned at the beginning of the article, the figures were so enormous (approximately £1bn.) that a special dispensation was sought, and received, from very senior personnel in the Treasury at the time. This was to the effect that notwithstanding the "letter of the law" the windfall tax that otherwise would have accrued to the Treasury was not to arise.

I rather doubt that similar concessionary treatment would apply now (some 30 years later), and therefore practitioners should always ensure that shares are issued whenever a capital contribution is made.

Finally, to complete the picture I should deal with the position where a UK company is involved. As capital contributions are not a concept formally recognised within UK company law, a contribution received by a UK company should be reported within distributable reserves either as a gift or possibly a donation. If, however, it can be repaid in any

circumstances the normal treatment (as far as HMRC are concerned) is that the contribution is to be considered as a loan falling within the loan relationships regime.

GENERAL ANTI-ABUSE RULE

Will anybody be brave enough to challenge the GAAR?

Peter Vaines

The genesis of the General Anti-Abuse Rule was a report by Graham Aaronson KC in 2011 which sought a solution for dealing with egregious tax avoidance arrangements.

The reference to *egregious* arrangements was a deliberate choice of words obviously designed to focus on tax avoidance arrangements which are "extremely bad or shocking".

Graham Aaronson suggested that a General Anti-Abuse Rule would deter artificial tax avoidance schemes that can only be regarded as wholly unacceptable. However, he sounded a warning:

> "Although clearly intended to apply only to egregious, or very aggressive, tax avoidance schemes, it was thought likely that HMRC may seek to apply the GAAR more widely".

The GAAR has indeed evolved exactly as feared. It is

now virtually the case that if the GAAR Panel can think of a way in which the relevant transaction could have been undertaken giving rise to more tax, then that is the tax which should be charged. The idea of the GAAR being confined to extremely bad or shocking tax avoidance arrangements has sadly gone out of the window, seriously eroding the protection of taxpayers which is rightly regarded as important.

It is no exaggeration (well barely) to suggest that the operation of the GAAR has caused Parliamentary sovereignty to be abandoned as far as tax is concerned; the GAAR Panel are able to (and do) overrule Parliament. I shall explain.

We can start with the declaration by the GAAR Panel that that they reject the approach taken by the Courts that taxpayers are able to reduce their tax bills by any lawful means. This is a startling (and extremely worrying) proposition.

(I would like to reject the approach taken by the courts that when I go to Waitrose I have to pay for the goods in my trolley. Obviously I cannot do that – but how come the GAAR Panel can simply decide that they can reject the law?)

Closer to home, an individual may do something to

reduce his tax liability, adhering precisely to the relevant legislation. His action is in accordance with the intention of Parliament; it is not struck down by any purposive interpretation (or any *Ramsay* variant) and is entirely effective for tax purposes. However, if the GAAR Panel take the view that the transaction *ought* to be taxed (despite Parliament saying it should not), HMRC can tax it.

They don't actually say that HMRC can tax it – but they give them the green light to do so; and of course, the taxpayer can always appeal through the normal appeal process. That sounds fair and reasonable – but it is entirely false. The taxpayer can appeal but if his appeal does not succeed there is a penalty of 60% of the tax. Sixty percent! A penalty of 60% for daring to challenge HMRC. Now that is really egregious. It is a sort of fiscal squid game; you win, or you die.

It is therefore hardly a surprise that nobody appeals against an assessment or closure notice made on the basis of a GAAR Panel decision.

This was foreseen in the 2011 Aaronson report, and he recommended that there should be no penalties so as to avoid HMRC using it as a weapon against the taxpayers. And what a weapon. HMRC don't even have

to mention it. (Nothing to do with me, guvnor!) Like nuclear capability, the mere existence of such a penalty carries a powerful threat, just because everybody knows it is there. At paragraph 5.48 he said:

> "I consider that including such provisions would be seen as presenting an irresistible temptation to HMRC to wield the GAAR as a weapon rather than to use it, as intended, as a shield. For this reason, I do not consider that it would be appropriate to include any provisions for applying special rates of interest or penalties to tax recovered by use of the GAAR".

It is often said that HMRC have a duty to collect tax according to the law, and there is not much which should be allowed to interfere with that duty. But what we have here is tax being charged *contrary* to the law. This means that the taxpayer is being forced to pay tax which is not payable according to the law, but just because HMRC say so. There is not even a pretence of any protection for the taxpayer if a department of state can decide that they do not like the law of the land and apply another set of rules which they prefer, to deprive citizens of their property. (Eat your heart out,

Montesquieu.)

This position is justified by saying that Parliament really intended something else, or did not anticipate these circumstances. However, it is HMRC and the GAAR Panel who decide what Parliament intended or anticipated. Which, without putting too fine a point on it, means that they decide what the law is – whatever Parliament may have said.

So when I said that the operation of the GAAR has caused Parliamentary sovereignty to be abandoned as far as tax is concerned, this is exactly what I meant. I seem, to remember that a while ago, dispensing with laws without the consent of Parliament gave rise to some domestic strife which ended in a bit of regicide (and a Bill of Rights).

Interestingly, although perhaps it is a little frustrating, there is only case relating to the GAAR which has hit the courts. *Wired Orthodontics v HMRC TC8679* was a tax avoidance scheme involving the provision of gold bullion to employees. HMRC referred it to the GAAR Panel who came down against it. On appeal the Tribunal held that the scheme did not work under the law so the GAAR aspects did not need to be considered (and it is assumed that there was therefore no penalty).

I expect the taxpayer has mixed feeling about that.

We really need a brave soul to mount a direct challenge to the operation of the GAAR having regard to the serious (and seriously unfair) risks to which it gives rise. It is traditionally difficult to challenge something as being unconstitutional because appeals are on the law, the law is laid down by Parliament, and Parliament is sovereign. However, the decisions of the GAAR Panel could be argued as being unconstitutional if they provide a result which is contrary to that which Parliament intended.

Such a person might take confidence or inspiration from the approach of the Courts to wholly unreasonable and penal legislation, where they bust a gut to find a sensible or just outcome. Two examples may suffice.

Where a company has failed to comply with their PAYE obligations, or there is good reason to believe that they might fail to do so, Regulation 97N of the PAYE Regulations authorises HMRC to require a company, or the directors, to provide security for payment of PAYE.

This is **really serious** because it is a strict liability criminal offence to fail to pay the security demanded

by HMRC. Like all strict liability offences, there is no defence. It is even more serious for the directors who are directly in the firing line. They naturally don't want to be subject to an unlimited fine – but even more importantly, they do not want a potentially career ending criminal conviction.

In *D-Media Communications Limited v HMRC [2016] UKFTT 439,* the Tribunal noted that the recipient of a notice to provide security for PAYE will be criminally liable merely for the failure to provide the security. If he simply does not have the funds, the inevitable consequence of the issue of a security notice will be that a criminal offence will be committed. No doubt influenced by the harshness of this rule, the Tribunal held that hardship should be a factor in the decision of HMRC to require security. (Nothing in the statute about that.) If the taxpayer cannot pay, and HMRC know he cannot pay, then to require the taxpayer to provide security – which he would inevitably fail to do and be criminally liable – can do nothing to protect the revenue, and this could not have been the purpose of Parliament in making these regulations.

The legislation is clear – there is no possible ambiguity. But it is so unfair and unreasonable that the

court found themselves able to modify the rule to avoid the clearly specified consequences, deciding that regulation 97N should be qualified by reference to the hardship caused to the taxpayer.

Another example arises where a person has defaulted on his VAT obligations and becomes liable to a penalty; he may have a reasonable excuse which can relieve him from the penalty. He might for example have done absolutely everything right: collated all his papers in good time, sent them to his expert professional accountant; checked with his accountant that all is in order. But if the accountant does not do what he should, and a default occurs, there will be a penalty. What more could the taxpayer have done? Surely he has a reasonable excuse, and he should be relieved of the penalty. Sounds like it, but Section 71(1)(b) VAT Act 1994 denies any possible relief from the penalty:

> "where reliance is placed on any other person to perform any task, neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse".

Again, the legislation is clear – there is no possible ambiguity. But again, it is so unfair and unreasonable

that the courts found a way to allow a reasonable excuse in such circumstances. They have decided that section 71 should be qualified so that it only applies where the taxpayer did not take reasonable care to try to ensure the third party fulfils the necessary obligations.

These cases show that the courts will (sometimes) intervene so that we end up with a rule which is tough but reasonably just and fair to both the specific taxpayer and the general body of taxpayers.

So it may be with the GAAR. Our brave soul could perhaps argue that a decision of the GAAR Panel which is clearly contrary to the intention of Parliament, should not have the effect of excluding, for all practical purposes, any right of appeal to the Courts, by the imposition of a penalty regime of overwhelmingly excessive proportions.

I suggest that it would be better, fairer and more in keeping with our highly valued system of justice and the rule of law, for the GAAR Panel to be a valuable second opinion facility for HMRC, and be afforded all the respect that the members of the Panel deserve. However, but it really should not be allowed to operate so as to deprive the taxpayer of a legitimate challenge

to the view of a department of state, by the threat of such an outrageous penalty. It is possible that in the event of a serious challenge, the Courts might find that the penalty provisions go too far, and that they should not be imposed except in some specific (perhaps egregious – now that's an idea!) circumstances.

TAXING TRIBUNALS & COURTS

Charting the course of Fiscal Disputes through Arbitration

Dilpreet K. Dhanoa

"Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism but peace, easy taxes, and a tolerable administration of justice: all the rest being brought about by the natural course of things."[1]

Introduction

Adam Smith is often quoted in taxation. His advice (as set out above) for a state to achieve peace and balance appears to rest on some fundamental ideals: avoidance of both repressive government civil conflict; an easy-to-administer tax system that has widespread compliance (collecting taxes at a reasonable cost from a broad base); and, a tolerable administration of justice and the legal infrastructure

[1] Adam Smith, 'An Inquiry Into the Nature and Causes of the Wealth of Nations' (1776).

that can support the enforcement of contracts and property rights in line with the rule of law.

The resolution of tax disputes has traditionally been the preserve of domestic courts and administrative bodies. However, the interplay between sovereign fiscal powers and the globalisation of commerce has engendered demand for alternative mechanisms – chief among them, arbitration. This article examines the contours of tax arbitration from the perspective of English law, exploring the domestic exclusion of tax disputes from arbitration under UK law, the emergence of binding arbitration in treaty contexts, the EU's directive-based approach, investor–state tribunals under bilateral investment treaties ("**BITs**") and the International Centre for Settlement of Investment Disputes ("**ICSID**") framework, and the practical considerations that shape the arbitration of fiscal controversies.

Domestic bar on tax arbitration?

This year (2025) saw Royal Assent given to the Arbitration Act 2025.[2] The new Act aims to insert a number of amendments into the existing Arbitration

[2] The Act is yet to come into force at the time of writing.

Act 1996, with the aim of modernising it and thus continuing to enhance the status of England and Wales as a leading international forum for dispute resolution. While dispute resolution, and in particular arbitration, is used across a variety of areas of law, it is not particularly common in the arena of taxation in the UK (certainly not for domestic disputes with HMRC – considered further below).

The current section 7 of the Arbitration Act 1996 (which the Arbitration Act 2025 does not amend) expressly excludes *"any proceedings under any enactment for the recovery of any sum imposed by or under any enactment" from its scope, effectively barring the arbitration of disputes concerning tax assessment, liability or recovery in England and Wales"*. This exclusion reflects both the constitutional doctrine that taxation is a sovereign prerogative and the public-law nature of fiscal disputes, which demand transparency, precedent and appellate oversight. Consequently, private parties in the UK cannot contract out of domestic tax litigation — tax tribunals and the Upper Tribunal (Tax and Chancery Chamber) ("**UT**") retain exclusive jurisdiction.

Whilst tax disputes with His Majesty's Revenue & Customs ("**HMRC**") usually have a default option for the taxpayer to engage in the ADR process, this form of dispute resolution is usually mediation. It is generally via the auspices of HMRC's mediation service (albeit independent mediators are appointed), and they can only be initiated by the taxpayer.

The topic of dispute resolution in tax is clearly a matter of some interest. Just last week,[3] the First-tier Tax Tribunal ("**FTT**") issued a Practice Statement encouraging parties to think more proactively about using ADR. It makes clear that:

> "ADR is a different way of dealing with a tax dispute with HMRC. It is a confidential process between you and HMRC that aims to:
>
> - help you resolve disputes in a cost-efficient way, or
> - reach agreement on which issues need to be decided by the Tribunal."

[3] 9 May 2025.

This article does not consider the effectiveness of such ADR, but what the revised Practice Statement goes on to state is the following:

> "An unreasonable failure to consider or enter into ADR may, in an appropriate case, result in costs being awarded against a party or in a party recovering a lower proportion of their costs…. Such conduct may also, in an appropriate case, constitute unreasonable conduct (for the purposes of rule 10(1)(b) of the FTT Rules)."[4]

In other words, there are serious costs implications for taxpayers – because the only route in which ADR can be engaged is through a formal request being submitted by the taxpayer for the same. It is not a process which can be instigated by HMRC. Whilst some might consider this an encouraging nod in the direction of ADR as a settlement process with a means to achieving a more cost-effective solution for the parties, it does call into question the role of ADR

[4] This Rule states that a Tribunal may make a costs order *"if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings"*.

versus the courts and whether ADR should in fact be mandated in certain circumstances.

European and international tax arbitration

One route that the UK previously had open to it (and is set out here for completeness), was the EU's dispute resolution framework for tax disputes between Member States. Within the EU, Council Directive 2017/1852[5] established a mandatory arbitration mechanism for disputes arising from the interpretation or application of double tax conventions between Member States. It requires Member States to refer unresolved cases to a two-tier arbitration panel and to publish final decisions. The two-tier system is effectively, Mutual Agreement Procedure ("**MAP**")-plus-arbitration regime for double-tax treaty ("**DTT**") disputes between Member States. After two years of MAP (extendable by one year in justified cases), taxpayers may request referral to an Advisory Commission, composed of:

(a) the component authorities of each State; and,

[5] Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union.

(b) three independent arbitrators (one serving as Chair) drawn from a list nominated by Member States.

The Commission adopts its own Rules of Functioning — or, failing agreement, defaults to the standard rules set out in Commission Implementing Regulation (EU) 2019/652 – and must issue its opinion within six months of constitution. Thereafter the States have three months to agree a final decision; if they do not, the opinion becomes binding and must be implemented notwithstanding any time-limits in domestic law. Member States may publish final decisions in full, subject to taxpayer consent, via the Commission's website.

Following Brexit, the UK revoked its implementing Regulations in early 2020, removing the Directive's application to UK taxpayers. UK practitioners must therefore rely on arbitration under bilateral treaties or standalone arbitration agreements concluded with foreign States – a route less regimented and potentially divergent in procedural safeguards than the EU's harmonised framework.

By contrast, international double taxation disputes between States may be submitted to arbitration

under Article 25(5) of the OECD Model Tax Convention: a second route open to the UK. In July 2008, the OECD Council amended Article 25 to introduce an optional binding arbitration clause, triggered when Competent Authorities fail to reach agreement on a MAP within two years of a taxpayer's request. The 2017 update to the Model further refined procedural rules and Sample Mutual Agreement on Arbitration, promoting consistency and efficiency across jurisdictions. This was in line with the OECD's Base-Erosion and Profit Shifting ("**BEPS**") Plan: in particular, BEPS Action Plan 14 which deals specifically with 'more effective dispute resolution mechanisms'.[6]

By 2023, disputes referred under the OECD arbitral provision for bilateral treaties based on the OECD Model, to MAP saw 62% of cases resulting in agreement fully eliminating and/or resolving the double taxation issue.[7] In short, it appears that the

[6] See: https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/dispute-resolution/beps-action-14-on-more-effective-dispute-resolution-peer-review-documents.pdf

[7] See: OECD 2023 MAP Statistics (https://www.oecd.org/en/data/datasets/mutual-agreement-procedure-statistics.html#breakdown)

route does provide taxpayers with a final, binding dispute resolution avenue beyond protracted state-to-state negotiations.

Investor-state dispute settlement ("**ISDS**") under BITs or investment chapters of trade agreements offers a third arbitration pathway: foreign investors may challenge state tax measures that violate treaty protections – most notably, unfair and inequitable treatment and indirect expropriation. Pursuant to Article 25(1) of the ICSID Convention, tribunals admit *"legal disputes arising directly out of an investment"*, which courts and tribunals have interpreted to include certain fiscal measures affecting the value or stability of investments. Critically, ISDS tribunals do not adjudicate the correctness of domestic tax law application; rather, they assess whether the challenged measure breaches treaty standards.[8] Significant examples include the cases of *Burlington Resources Inc. v. Ecuador*[9] and *Perenco Ecuador Ltd v. Ecuador*.

[8] As noted above, this includes *inter alia*, fair and equitable treatment or indirect expropriation.
[9] *Burlingon Resources Inc. v. Republic of Ecuador*, ICSID Case No. ARB/08/5.

In the cases of *Burlington Resources* and *Perenco*, both entities challenged Ecuador's retroactive 'windfall' taxes ("Law 42") under the U.S.-Ecuador and France-Ecuador Bilateral Investment Treaties ("**BITs**"), respectively. The U.S. BIT's broad tax carve-put foreclosed expropriation claims in *Burlingon*, whereas *Perenco* succeeded under its narrower carve-out. ICSID awards benefit from the Convention's self-executing enforcement mechanism. UNCITRAL-seated awards, by contrast, depend on the New York Convention and remain vulnerable to setting-aside or refusal on public-policy grounds.

Key practical considerations for arbitration of tax disputes

There are a number of key practical considerations which should be borne in mind when considering arbitration as a mechanism to resolve tax disputes.

(1) Seat and Applicable Rules

For treaty-based arbitration (OECD MAP arbitration), parties often select ICSID Rules, UNCITRAL Rules or bespoke procedural rules. The seat determines national procedural law ('lex arbitri') and supervisory court support – critical

where domestic courts retain intervention rights. In ISDS, ICSID arbitrations are insulated from domestic judicial review, whereas UNCITRAL-seated arbitrations may attract annulment or anti-suit injunction challenges.

Choosing the seat of arbitration is no mere formality: under section 3 of the Arbitration Act 1996, the *lex arbitri* (the law of the seat) governs fundamental matters such as the court's supervisory jurisdiction, arbitrability, competence-competence, and grounds for setting aside an award (section 68). In OECD MAP cases, parties frequently adopt:

(a) ICSID Rules, where the seat (and therefore annulment regime) is governed by the ICSID Convention,[10] insulating awards from domestic court challenge but allowing only the narrow ICSID Annulment Committee to review awards;

(b) UNCITRAL Rules, seated in London under the Model Law as enacted in the Arbitration Act, enabling a final award enforceable under both the New York

[10] Articles 52-54.

Convention and the Act,[11] but exposing it to English court annulment challenges[12] or anti-suit injunctions[13] if, for instance, a foreign State or State entity seeks to reopen proceedings elsewhere;

(c) Institutional Rules (e.g. ICC, LCIA), which overlay bespoke timelines, emergency arbitrator provisions and administrative support – valuable to contain the often protracted MAP process.

For ISDS, ICSID-seated disputes are wholly divorced from national courts (save for limited enforcement steps under Article 54), whereas UNCITRAL-seated BIT arbitrations – even when seated in London – remain subject to English supervisory review, including challenges to jurisdiction or award on public-policy grounds, setting-aside applications, or

[11] Sections 66-69.
[12] Section 68.
[13] Section 44.

anti-suit injunctions to restrain parallel domestic litigation.[14]

(2) Tribunal Composition and Expertise

The technical complexity of tax disputes necessitates tribunals combining legal, accounting and economic expertise. Parties frequently appoint co-arbitrators with tax-treaty background and agree upon a chairman skilled in international tax policy.

Institutional rules[15] now expressly permit the tribunal to appoint *"party-appointed experts"* or to call for tribunal-appointed experts under IBA Guidelines on Party-Expert and Witness Conferencing. While such experts can clarify transfer-pricing methodologies or complex fiscal valuations, their involvement must be carefully managed to avoid conflicts of interest, breaches of equal treatment and procedural unfairness under Article 18(2) of the UNCITRAL Rules or section 33 of the 1996 Act.

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[14] See: case of *Allianz SpA v. West Tankers* (Case C-185/07). This is a preliminary ruling by the Court of Justice of the European Union following a reference from the House of Lords (as it then was).

[15] For example, ICC Article 12(7), UNCITRAL Model Arbitration Rules Article 11.

(3) Confidentiality versus Transparency

Confidentiality has long been a cornerstone of arbitration, prized by taxpayers and sovereigns alike. This hallmark of confidentiality may conflict with public interests in tax transparency, however. EU legislation mandates publication of reasoned awards, while many BIT arbitrations remain confidential. Practitioners must advise States on balancing taxpayer privacy, state confidentiality and international transparency commitments (notably, the OECD's BEPS peer-review processes).

For example, EU Directive 2017/1852 upends that paradigm in intra-EU cases by mandating publication of reasoned awards and non-anonymous summaries (Article 7), to bolster legal certainty and peer review under the BEPS Action 14 peer-review framework. Similarly, the 2013 UNCITRAL Transparency Rules (applicable in many investment treaties) require notice of disputes, publication of key documents and open hearings – counter-balancing the traditionally clandestine nature of BIT arbitrations.

Advice to States on drafting confidentiality clauses will therefore usually include aspects that reconcile:

(a) Taxpayer privacy (protecting sensitive financial data and trade secrets);

(b) State confidentiality (preserving fiscal sovereignty and internal policy deliberations);

(c) International commitments (OECD peer-review, EU transparency, G20/OECD BEPS minimum standards).

Poorly calibrated rules risk either triggering data-protection breaches or running afoul of transparency obligations, potentially invalidating binding provisions or exposing awards to public-policy challenge.

(4) Enforceability of Awards

Under the New York Convention, arbitral awards are enforceable across 170+ signatory States, facilitating cross-border tax recovery or treaty-compliant relief. ISDS awards under ICSID benefit from the ICSID Convention's sui generis enforcement mechanism. However, awards annulling tax assessments may collide with sovereign immunity claims or domestic public-policy exceptions, requiring careful drafting of arbitration agreements and treaty provisions.

The New York Convention offers broad enforcement in 170+ States, normally precluding review on merits and limiting refusal to narrow public-policy exceptions. English courts routinely grant ex parte enforcement *ex parte* under section 66 of the 1996 Act and the Convention, enabling swift cross-border recovery of disputed amounts or injunctive relief.

By contrast, ICSID awards benefit from Article 54's self-executing enforcement: once registered, they are not subject to domestic public-policy or sovereign-immunity defences (save manifest excess of powers) and must be enforced as if a final judgment of that State's courts. However, awards annulling domestic tax assessments can still encounter hurdles:

(a) Sovereign immunity claims by State departments (e.g. revenue authorities) seeking to avoid enforcement in non-ICSID jurisdictions;

(b) Public-policy exceptions in national courts (for UNCITRAL awards) where the court perceives an award as interfering with core fiscal prerogatives;

(c) Scope of relief — awards typically order payment of sums, but cannot directly

amend domestic tax law, requiring confirming orders or fresh assessments in the taxpayer's favour.

Careful drafting of arbitration clauses and treaty provisions — stipulating clear scope of authority, enforceable relief and waiver of immunity — minimises these risks and secures the practical efficacy of arbitration for resolving high-stakes fiscal disputes.

Conclusion

Pillar 1 of the OECD/G20 BEPS Project recognised the need to improve dispute resolution. Action 14 (as referenced above) endorsed mandatory binding arbitration as a minimum standard, now incorporated into the Multilateral Instrument ("**MLI**"), which overlays existing treaties with arbitration clauses without reopening bilateral negotiations. The UK has signed but not yet ratified the MLI arbitration provisions. Domestic proposals – such as a Review of the Arbitration Act 1996[16] – may revisit the exclusion of tax matters, although no

[16]See: Law Commission's Report (https://lawcom.gov.uk/project/review-of-the-arbitration-act-1996/).

concrete legislative amendments have been tabled and the new Arbitration Act 2025 has not considered them.

Arbitration offers an increasingly vital avenue for resolving complex cross-border tax disputes. While domestic arbitration of tax assessment remains barred in the UK, practitioners can harness treaty arbitration under the OECD Model and investor–state mechanisms for effective, binding resolutions. Mastery of the applicable legal frameworks, procedural nuances and enforcement regimes is essential for advisors guiding sovereigns, multinational enterprises and high-net-worth individuals through the evolving landscape of fiscal arbitration. It is an interesting and intriguing landscape, that offers much opportunity but without guaranteed certainty of outcome.

INCORPORATING A PROPERTY LETTING PARTNERSHIP

Riya Bhatt

Introduction

Those carrying on a property letting partnership may consider the option of incorporating in order to obtain the benefits of a lower corporation tax rate compared to the income tax rate.

Incorporation can be carried out in a tax-efficient manner with no immediate charge to SDLT or CGT, as long as certain conditions are met.

Existence of a partnership

The starting point is that a partnership must exist.

Section 1(1) of the Partnership Act 1890 defines a partnership as:

> "*the relation which subsists between persons carrying on a business in common with a view of profit*."

There are thus three elements to be considered when determining whether a partnership exists: (i) there must be a business; (ii) which is carried on in common by two or more persons; and (iii) the business must be carried on with a view of profit.

If all three conditions are met, a partnership will exist. This will allow the partners to incorporate the business without an SDLT charge, and (provided certain conditions are met) without an immediate CGT charge.

(i) A business

Section 45 of the Partnership Act 1890 defines "business" as including "*every trade, occupation, or profession*".

The existence of a 'business' in the context of letting property has been considered in a number of cases.

In *American Leaf Blending Co v Director-General of Inland Revenue* [1978] 3 All ER 1185, the Privy Council held that letting out property five times to different tenants over a period of five years, and the removal of machinery to allow the building to be let, constituted the carrying on of a business.

In *Sahota v Sohi* [2006] EWHC 344 (Ch), the taxpayers owned three properties as part of a property portfolio and let these out to tenants. This was accepted by Park J to constitute a partnership to carry on a property investment business.

Similarly, in *Ward and another v Fairhead* [2002] EWHC 3222 (Ch), the High Court determined that a business (and a partnership) existed where the parties acquired two properties and let them to exploit them for profit.

In *Ramsay v HMRC* [2013] STC 1764 ("***Ramsay***"), the taxpayer owned a share in a property which was divided into ten flats. The activities carried out by the taxpayer included meeting tenants, paying electricity bills, arranging insurance policies, unblocking drains, maintaining the garage and communal areas, checking the security of the windows and doors of the property, and cleaning the flats in preparation for new tenants. In total, the taxpayer and her husband spent approximately 20 hours per week carrying out these various activities in relation to the property and neither had any other occupation.

The Upper Tribunal considered whether these

activities were:

> "a 'serious undertaking earnestly pursued' or a 'serious occupation', whether the activity was an occupation or function actively pursued with reasonable or recognisable continuity, whether the activity had a certain amount of substance in terms of turnover, whether the activity was conducted in a regular manner and on sound and recognised business principles, and whether the activities were of a kind which, subject to differences of detail, are commonly made by those who seek to profit by them."

It found at [65] that the activities of the taxpayer were enough to fall within the above tests.

The Upper Tribunal held at [67] that the overall activity undertaken by the taxpayer in respect of the property was "sufficient in nature and extent to amount to a business". The Tribunal stated:

> "Although each of the activities could equally well have been undertaken by

> someone who was a mere property investor, where the degree of activity outweighs what might normally be expected to be carried out by a mere passive investor, even a diligent and conscientious one, that will in my judgment amount to a business."

This case suggests that where there is active involvement by the taxpayer in the activities relating to the properties, a business is likely to exist.

In contrast to the decision in *Ramsay*, the Special Commissioners in *Rashid v Garcia (Status Inspector)* [2003] STC (SCD) 36 held that there was not sufficient activity for the letting of the properties to constitute a business. In that case, the appellant received rental income from four properties. In relation to the properties, he made arrangements for the utilities, he drafted advertisements for new tenants, made credit checks on prospective tenants, made up inventories, drew up the tenancy agreements, inspected the property, cleaned common parts, and maintained the garden.

This was held not to constitute a business. Rather, it

was an investment which by its nature required some activity to maintain it, rather than a business. This was because although the appellant had some responsibilities when things went wrong, he did "nothing more than a landlord normally does".

The Upper Tribunal in *Ramsay* distinguished *Rashid v Garcia* on the basis that the legislation in point (regarding CGT rollover relief) did not align the term "business" with trades, professions and vocations. In contrast, the statutory provisions relevant in *Rashid v Garcia* (in the context of national insurance contributions) "*took its colour from an association in the statutory definition with trades, professions and vocations*."

In *Durkan (as liquidator of Long Compton Project Limited) v Nicholas Mark Jones* [2023] EWHC 1359 (Ch), the High Court found that the mere ownership of property, and the letting of that property and receipt of rent, was sufficient to constitute the carrying on of a business in the context of insolvency proceedings (albeit that the statutory definition of "business" was not aligned with trades, professions and vocations). The High Court also stated that the

rent received from the property was not modest by usual standards, but a business need not be conducted to any specific scale: the sums of money involved cannot be determinative, and nor can the number of properties involved. On the facts before the High Court, it was found that a business was being carried on.

It must be noted that the test for determining whether a partnership exists rests on the existence of a "business" as opposed to a "trade". HMRC accepts that the term "business" is wider than "trade", and thus whilst property investment may not constitute a trade, it may constitute the carrying on of a business.

This was acknowledged in *Griffiths v Jackson* [1983] STC 184, where the activities of the taxpayers were accepted to constitute a business, even though they did not constitute a trade. In that case, the taxpayers' typical evening of work in relation to their properties which were let including "collecting rents, inspecting properties, arranging lettings and ironing out problems of tenants."

HMRC accept the above position; its Manual

CTM36560 states:

> "it is possible for an activity not to amount to a trade or profession and still be within the definition of 'business' in the Partnership Act 1890. Property and investment management, carried on as a commercial venture, may fall into this narrow category. Such partnerships are sometimes known as 'investment partnerships'."

However, the mere ownership of property in joint names is unlikely to be enough to constitute the carrying on of a business.

HMRC's Manual PIM1030 provides more detail as to the requirements of a property investment business:

> "Most cases of jointly owned property will fall short of the degree of business organisation needed to constitute a partnership. To accept that a partnership exists you would have to be satisfied that there is a similar degree of business organisation as in an ordinary

> commercial business. This means more than treating rental income as derived from a business of letting property - it must be business apart from that."

It is clear that the question of whether an activity constitutes a business is a highly fact-sensitive enquiry.

The activities in question must be carried on with a degree of organisation and continuity, and must go beyond what might normally be expected of a mere passive investor.

In terms of required hours to be spent on the business, HMRC accepted that 20 hours per week was sufficient in *Ramsay*. However, it is important to remember that the activities carried out by the purported partnership must be considered as a whole, as opposed to merely counting hours worked. It is certainly arguable that a taxpayer who spends 15 hours per week working on their property portfolio is still carrying on a business, as long as the activities carried out are more than what a landlord normally does, and that the activities are carried on with a degree of organisation and commerciality.

(ii) Carried on in common

To prove that a partnership exists, it must be shown that two or more persons are carrying on a single business together.

In *Ashton v HMRC* [2016] UKFTT 727 (TC) ("***Ashton***"), the First-tier Tribunal held that the in order to be a partner, a person must be involved in the running of the business as a whole. In that case, although the taxpayer was named on the partnership returns as a partner and the taxpayer's self-assessment returns were prepared on the same basis, and the taxpayer was a signatory on the partnership savings account, he was found not to be a partner. He did not receive partnership accounts or a copy of the partnership agreement, he was paid a basic amount each month, he had no liability for the burden of losses in the business, he had no control over the partnership savings account, and he had no control over the way the partnership business was run.

Similarly, in *Commissioners of Inland Revenue v Williamson* 14 TC 335, there was held to be no partnership because although the taxpayer and his sons had a lease as joint tenants, the taxpayer

himself undertook the transactions in relation to the business, the bank account of the business was in his name and operated solely by him, there was no record to show the existence of a contractual relation between the taxpayer and his sons, and all the taxpayer's sons did was work on the farm. This was despite the fact that the taxpayer and his sons all had a general understanding that the business was being carried on in partnership. The Lord President Clyde held "that is not proof of partnership at all".

There was also held to be no partnership in *Valantine v HMRC* [2011] UKFTT 808 (TC). There, the First-tier Tribunal held that the taxpayer was not jointly engaged in a partnership business with her husband, albeit she had financed some items for the business. She was not actively engaged in the trading, she had nothing to do with the running or management of the business, and any receipts she received from her husband were more realistically attributed to the reimbursement of items she had paid for. Fundamentally, the estranged relations between the taxpayer and her husband made it

"unthinkable" that the taxpayer would have engaged in any way in the business.

In *SC Properties and another v HMRC* [2022] UKFTT 00214 ("***SC Properties***"), a husband and wife claimed to be carrying on a property development business in partnership with each other. However, the First-tier Tribunal held that a partnership did not exist. It did not accept the argument that because the business was carried on by a husband and wife, it should not be expected that the usual formalities of a partnership would be in place. The First-tier Tribunal held that where a partnership is alleged between spouses, the evidence of both parties as to their relationship in carrying on the business was important. In addition, the relationship must carry on "*the hallmarks of a relationship over and above the normal relationship which one would expect from spouses who share a bank account and make joint decisions about finances and where they want to live*."

The First-tier Tribunal placed emphasis on the fact that none of the relevant documents made reference to the partnership, and were all only signed in the

names of the spouses. This, taken with evidence of the advice given to the individuals as to the creation of a partnership by their advisers, resulted in the taxpayers failing to demonstrate that the partnership existed. Rather, it was something which was suggested by the individuals' financial advisers, and "*which existed only when the relevant tax and accounting forms were completed, but had no substantive existence in the real world*."

In addition, the First-tier Tribunal held that the partnership was not carrying on a business because no evidence had been provided to demonstrate the same. The partnership did not have its own bank account and was not VAT registered. It did not issue any invoices or enter into the contracts for the development of the property.

In contrast, in *Reneaux and another v HMRC* [2019] UKFTT 0666 (TC) ("***Reneaux***"), the First-tier Tribunal held that even though the taxpayers were divorced at the relevant time, they agreed to a joint course of action to realise income from property, and therefore they were carrying on a business in common. This was held to be the case even though

the taxpayers did not enter into any formal partnership agreement, and nor did they report their income from their business as partnership income to HMRC. This was found to be because they "were simply unaware of the need to do so", as they had not engaged the services of an accountant.

Similarly, in *George Hall & Son v Platt* (Inspector of Taxes) 35 TC 439, the High Court held that there was a partnership where there was an agreement that farmers and merchants would grow crops on land occupied by the Appellant. The Appellant was to provide horse labour under the agreement, and the merchants were to provide seeds, manure and hand labour, and harvest and sell the crop. The parties were to be paid their expenses out of the proceeds and any balance was to be divided equally. Although there was no joint ownership of property, no joint account, no joint employees, and no common duty or obligation which the parties needed to share, a partnership was held to exist.

It is clear from the cases that both purported partners must be intended to carry on the property business together. The existence of formal

partnership documents is relevant, but not determinative, especially if there is a good reason for the lack of documents.

Section 2(2) of the Partnership Act 1890 states:

> "The sharing of gross returns does not of itself create a partnership, whether the persons sharing such returns have or have not a joint or common right or interest in any property from which or from the use of which the returns are derived."

However, section 2(3) of the Partnership Act 1890 goes on to provide:

> "The receipt by a person of a share of the profits of a business is *prima facie* evidence that he is a partner in the business, but the receipt of such a share, or of a payment contingent on or varying with the profits of a business, does not of itself make him a partner in the business…"

As such, although the mere sharing of returns and the receipt of business profits does not *necessarily*

indicate the existence of a partnership, these are both indications that a partnership does exist and that the person receiving such a share of profits is a partner in the business.

If the purported partners carry on the business together, and are both entitled to receive equal shares of profit from the business and are equally liable for its debts, this would be a clear indication that the business is carried on in common.

(iii) With a view to profit

The requirement of 'with a view to profit' is relatively straightforward and usually does not pose any issues. It is important to note that it must be intended that the *partnership* makes a profit, not that a profit will be made by the future incorporated company.

In *SC Properties*, the First-tier Tribunal held that if a partnership did exist, it was not carrying on a business with a view to profit because it was intended that any profit that could be derived from the property development business should not accrue to

the partnership, but rather to the acquiring company.

Stamp Duty Land Tax (SDLT)

As noted above, if all three conditions in section 1(1) of the Partnership Act 1890 are met, then a partnership will be held to exist.

If this is the case, the partners will be able to incorporate the property letting business into a new company without an SDLT charge through the operation of Schedule 15 to the Finance Act 2003 ("**FA 2003**").

Paragraph 18 of Schedule 15 FA 2003 deals with transactions involving the transfer of a chargeable interest from a partnership. It states:

> "*Transfer of chargeable interest from a partnership: general*
>
> **18** (1) This paragraph applies where a chargeable interest is transferred –
>
> (a) from a partnership to a person who is or has been one of the partners, or

(b) from a partnership to a person connected with a person who is or has been one of the partners.

(2) The chargeable consideration for the transaction shall (subject to paragraph 24) 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.

(5) Paragraph 20 provides for determining the sum of the lower proportions.

…"

In other words, pursuant to paragraph 18 of Schedule 15, the chargeable consideration for the transfer of a chargeable interest will be deemed to be an amount calculated by reference to the equation in paragraph

18(2) of Schedule 15, regardless of the consideration actually paid for the chargeable interest.

Paragraph 18 of Schedule 15 applies where there is a transfer of a chargeable interest from a partnership to a person connected with a person who is or was one of the partners. Therefore, the newly incorporated company ("**New Co**") must be connected to at least one of the partners of the partnership.

Paragraph 39 of Schedule 15 notes that s.1122 Corporation Tax Act 2010 ("**CTA 2010**") has effect for the purposes of Part 3, Schedule 15 (which includes paragraph 18 of Schedule 15).

Section 1122(3) CTA 2010 states that a company is connected with another person ("A") if A has control of the company, or A together with persons connected to A have control of the company.

"Control" is defined in s.1124 CTA 2010 as the power of a person to secure (by means of shareholding or voting power, or through powers conferred by the articles of association) that the affairs of the company

are conducted in accordance with that person's wishes.

It is likely that neither partner will have full control over New Co because they are its joint owners. However, the partners will be connected to each other by virtue of s.1122(4) CTA 2010, which states that any two or more persons acting together to secure or exercise control of the company are connected with one another. The partners will have a 100% shareholding of New Co between them, and thus they will be connected to each other.

It may be prudent to include a clause in the articles of association of the newly incorporated company that the partners have control over the company. The suggested wording is:

> "*The [A shareholder] and the [B shareholder] shall at all time act together to secure or exercise control of the company within the Corporation Tax Act 2010 s1123(4).*"

The same can be mentioned in the minutes/resolutions adopting the articles of

association. This approach puts the mind of HMRC at ease.

This means that New Co will be connected with the partners under s.1122(3) CTA 2010 because the partners are connected under s.1122(4) CTA 2010, and together they have control of New Co.

As such, paragraph 18 of Schedule 15 will apply to the proposed transfer of the properties to New Co because there will be a transfer of a chargeable interest from a partnership to a person connected with a partner.

On the transfer of the business to the new company from the partnership, the chargeable consideration will be deemed to be £Nil. This is because the equation in paragraph 18(2) of Schedule 15 will return a value of zero.

A worked example of the calculation is provided in HMRC's Manual SDLTM33760.

As the chargeable consideration on the transfer is deemed to be £Nil, there will also be no SDLT payable on the transaction, as SDLT is charged on the chargeable consideration.

In this way, the partners can incorporate their property letting business without an SDLT charge.

Capital Gains Tax (CGT)

The partners can also make use of CGT rollover relief.

Section 162 of the Taxation of Chargeable Gains Act 1992 has the effect that if certain requirements are met, the gain made on business assets can be rolled over and charged when the shares in the newly incorporated company are disposed of.

The conditions for the relief are:

1. The transfer must be by a person who is not a company (e.g. a partner in a partnership).
2. The person must transfer a business as a going concern to a company.
3. The transfer must include all the assets of the business, except cash.
4. The consideration for the transfer must be wholly or partly provided by shares issued by the transferee company.

If the above four conditions are met, the rollover relief in s.162 TCGA 1992 applies automatically. A taxpayer can elect for the relief not to apply pursuant to s.162A TCGA 1992.

As noted above, if rollover relief does apply, the gain on the business assets transferred to New Co will not be charged to CGT on the transfer. Instead, the gain will be charged when the shares of New Co received in consideration for the business assets are disposed of in the future.

The "super relief" here is that the properties within New Co can later be sold with their values effectively rebased to the market values on the date of the transfer to New Co.

Conclusion

There is a good opportunity for incorporation without an SDLT or CGT charge if you are carrying on a property letting partnership. However, you must ensure that any charges or mortgages on the properties allow transfers to a new company.

CASE NOTE *ROYAL BANK OF CANADA V HMRC* [2025] UKSC 2

David Tipping

Introduction

It is easy to dismiss the Supreme Court's decision earlier this year in *Royal Bank of Canda v HMRC* [2025] UKSC 2; [2025] STC 309 as of niche importance, and a somewhat unusual candidate for consideration by the highest court in the land.

The principal question for the court was whether the right to payments in consideration for disposing of the shares in a UK company which had the rights to exploit oil reserves on the North Sea Continental Shelf was income from immoveable property, and therefore taxable in the UK under the UK-Canada Double Tax Treaty (the **UK-Canada Convention**). This substantive issue is undoubtedly of significant importance to those operating in this field, but is unlikely to trouble readers who are not immersed in the sector.

The decision is nevertheless of wider interest in light of the Supreme Court's near-unanimous comments

on taking a 'realistic view' of the facts. The Supreme Court reaffirms the orthodox view that not all tax foregone in the United Kingdom is the result of "tax avoidance". Its level-headed and reasoned decision is to be welcomed. However, of greater interest are the majority's comments on the elusive *Ramsay* principle, which show signs of yet another shift in judicial approach.

Background Facts

Sulpetro was a Canadian company, with experience in oil and gas extraction. It set up a UK subsidiary, Sulpetro (UK) Ltd, for the purpose of extracting oil in the North Sea Continental Shelf.

Sulpetro (UK) was granted a licence by the UK government to explore a particular section of the North Sea Continental Shelf, known as the Buchan Fields, and to extract oil that it found. Sulpetro (UK) entered into an agreement with Sulpetro that the parent company would provide all the funding and equipment to carry out its activities; that Sulpetro (UK) would carry out its operations as directed by Sulpetro and, in return, Sulpetro was entitled to all the oil that its subsidiary extracted.

In 1986, BP acquired the shares in Sulpetro (UK) and Sulpetro's rights under its agreement to the oil. In return, BP promised to make additional payments to Sulpetro in proportion to the oil received (the **Payments**), if the price of oil exceeded a certain figure.

Sulpetro was heavily indebted to the Royal Bank of Canada (**RBC**) and, in 1987, entered into receivership. As a result, Sulpetro's rights to the Payments was assigned to RBC. The condition for making the Payments was not satisfied until 2000, from which time the Payments were made every year to RBC until production ceased in the Buchan Fields in 2017.

RBC treated the Payments as income of its banking business in Canada and, in accordance with article 7 UK-Canada Convention (Business Profits) paid tax on the Payments in Canada. Although RBC did (and does) have a UK branch, it was agreed that the Payments were attributable to the head office in Canada and not its permanent establishment in the UK.

HMRC became concerned that BP was claiming a deduction in respect of the payments, but there was

no corresponding tax being paid by RBC in the UK. Internally, HMRC's oil & gas expert described this as a hole in the legislation and issued assessments against RBC for unpaid corporation tax in the UK.

Legislative Regime

Ordinarily, a non-resident company is only liable to tax on profits attributable to a permanent establishment in the UK (section 5(2) CTA 2009). However, income from oil-related activities are deemed to arise from a permanent establishment in the UK, whether or not one exists (see, for example, section 279 CTA 2010). In particular, HMRC relied on section 1313 CTA 2009, which provides as follows:

> "(1) Any profits—
>
> (a) from exploration or exploitation activities carried on in the UK sector of the continental shelf, or
>
> (b) from exploration or exploitation rights,
>
> are treated for corporation tax purposes as profits from activities or property in the United Kingdom.

(2) Any profits arising to a non-UK resident company—

(a) from exploration or exploitation activities, or

(b) from exploration or exploitation rights,

are treated for corporation tax purposes as profits of a trade carried on by the company in the United Kingdom through a permanent establishment in the United Kingdom.

(3) In this section—

"exploration or exploitation activities" means activities carried on in connection with the exploration or exploitation of so much of the seabed and subsoil and their natural resources as is situated in the United Kingdom or the UK sector of the continental shelf,

"exploration or exploitation rights" means rights to assets to be produced by exploration or exploitation activities or to

> interests in or to the benefit of such assets, and
>
> "the UK sector of the continental shelf" means the areas designated by Order in Council under section 1(7) of the Continental Shelf Act 1964 (c 29)."

In HMRC's view, the Payments were profits arising from "exploration or exploitation activities" within the meaning of subsection (3), and therefore taxable as the profits of a trade attributable to a deemed permanent establishment in the UK.

This domestic legislation is supplemented by the UK's obligations under the UK-Canada Convention. In accordance with the ordinary position under the OECD Model Convention, article 7 UK-Canada Convention provides that business profits are taxable only in the taxpayer's state of residence, unless those profits are attributable to a permanent establishment. "Permanent establishment" in that context takes its meaning from articles 5 and 27A UK-Canada Convention. The latter provides explicitly for a deemed permanent establishment in relation to the exploration or exploitation of natural resources in the seabed. Despite this extended

meaning, it was agreed between the parties that RBC did not have a permanent establishment in the UK for the purposes of the UK-Canada Convention, because it was not carrying out the exploration or exploitation activities itself – instead, it was Sulpetro (UK) who carried out these activities.

Instead, HMRC relied on article 6 UK-Canada Convention, which reads:

> "**Article 6 Income from Immovable Property**
>
> 1. Income from immovable property, including income from agriculture or forestry, may be taxed in the Contracting State in which such property is situated.
>
> 2. For the purposes of this Convention, the term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated. The term shall in any case include … **rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources**; ships, boats and

> aircraft shall not be regarded as immovable property. (**emphasis added**)"

HMRC argued that the UK was entitled to tax RBC even though it did not have a UK permanent establishment, because the Payments were income from immoveable property by reason of the words in bold in article 6(2) above: the Payments had been consideration for BP's right to work the Buchan Fields through Sulpetro (UK).

RBC argued for a narrower interpretation of article 6(2). RBC said that the words in question were concerned only with the grant of the right to work by the person who owned the natural resources and that it did not include consideration for the transfer of a right to work the resources.

Decisions Below

The FTT dismissed RBC's appeal. It considered RBC's interpretation of article 6(2) was susceptible to tax avoidance by interposing an intermediary company. It held that the Payments amounted to rights to the benefit of the oil from the Buchan Fields, and was therefore taxable in the UK.

That decision was upheld on appeal to the Upper Tribunal, but allowed by the Court of Appeal.

On appeal to the Supreme Court, there were three issues to be decided:

Issue 1 – Did the rights that Sulpetro acquired under its agreement with Sulpetro (UK) add up to the 'right to work' the Buchan Field within the meaning of article 6(2)?

Issue 2 – If the answer to issue 1 is yes, were the Payments 'consideration for' those rights?

Issue 3 – If the Payments are within the scope of article 6(2) of the UK/Canada Convention, are the Payments profits arising to RBC from rights to the benefit of assets to be produced by the exploitation of UK natural resources for the purposes of section 1313?

Supreme Court's Judgment

Lady Rose, with whom Lord Lloyd-Jones, Lord Hamblen and Lord Legatt agreed, gave the majority judgment.

Issue 1

In relation to Issue 1, Lady Rose held that Sulpetro

had not acquired the "right to work" the Buchan Field, and therefore the Payments fell outside of article 6(2). Although Sulpetro provided funding and equipment to Sulpetro (UK), it was always the subsidiary company that held the licence to work the Buchan Fields and not Sulpetro itself. There was no direct legal relationship between Sulpetro and the UK Government, which was the only entity that could grant the right to work the Buchan Field. It had granted that right to Sulpetro (UK). The conclusion for which HMRC had argued would be ignoring the legal reality of the arrangements between the two companies.

Lady Rose quoted with approval from Falk LJ's judgment in the Court of Appeal at paragraph 113:

> "113 … The right to work was held by [Sulpetro (UK)]. The structure reflected in the Illustrative Agreement was put in place to meet the UK's own requirements. That legal structure cannot simply be ignored on the basis of some broader concept of commercial or economic reality."

The alternative way in which the argument was put was that the agreement between Sulpetro and Sulpetro (UK) resulted in Sulpetro assuming the entirety of the economic risks in relation to the exploration and exploitation of the Buchan Field. HMRC argued that this was an arrangement that no independent parties negotiating at arm's length would have agreed, and the only reason it was agreed in this way was because Sulpetro (UK) was a wholly-owned subsidiary. In those circumstances, it was really Sulpetro exercising the right to work under the licence, through its subsidiary company.

Lady Rose also rejected this argument. Again in agreement with Falk LJ, the Supreme Court considered HMRC's argument as contrary to the fundamental principle of corporate legal personality, recognised in *Salomon v A Salomon & Co Ltd* [1897] AC 22. In essence, HMRC's argument eroded the distinction between Sulpetro and Sulpetro (UK).

The Supreme Court accepted RBC's criticism of the FTT and UT decisions. In reaching the conclusions that they had, the tribunals were making an implicit assumption that the income generated in the North Sea 'should' be taxed in the United Kingdom. It

followed from this assumption that, because RBC's income was not being taxed in the UK, it was in some sense engaged in a type of avoidance activity. However, RBC had paid tax on the Payments in Canada. The Supreme Court correctly noted that this dispute was not about whether the Payments should be subject to tax or exempt, but whether they are subject to tax in the UK or Canada. That question could not be answered by an inherent presumption in favour of one State over another, but by an impartial construction of the UK-Canada Convention.

Having decided Issue 1 in favour of RBC, that was sufficient to dispose of the appeal. However, because the Supreme Court heard full arguments from both parties in relation to the other Issues, it gave reasoned judgments in respect of each. The court's reasoning is outlined only briefly below, before returning to a discussion of these references to legal versus economic realities.

Issue 2

Even if the rights acquired by Sulpetro under its agreement with Sulpetro (UK) had amounted to the "right to work" the Buchan Field, the Supreme Court

would have held that the Payments were not consideration for this right.

The court's reasoning is grounded in the interpretation of article 13 UK-Canada Convention, which deals with capital gains. Article 13(1) provides that capital gains from the disposal of immoveable property (as defined in article 6(2)). Article 13(4) and (5) read as follows:

> "4. Gains from the alienation of:
>
> (a) any right, licence or privilege to explore for, drill for, or take petroleum, natural gas or other related hydrocarbons situated in a Contracting State, or
>
> (b) any right to assets to be produced in a Contracting State by the activities referred to in sub-paragraph (a) above or to interests in or to the benefit of such assets situated in a Contracting State,
>
> may be taxed in that State.
>
> 5. Gains from the alienation of:

(a) shares, other than shares quoted on an approved stock exchange, deriving their value or the greater part of their value directly or indirectly from immovable property situated in a Contracting State or from any right referred to in paragraph 4 of this Article, or

(b) an interest in a partnership or trust the assets of which consist principally of immovable property situated in a Contracting State, of rights referred to in paragraph 4 of this Article, or of shares referred to in sub-paragraph (a) above,

may be taxed in that State."

The effect of these paragraphs together is to ensure that gains arising from the alienation of rights relating to hydrocarbons are taxed in the State where those resources are situated, whether or not an intermediate company is interposed into the transaction. As a matter of logic, some of the property to which paragraphs (4) and (5) relate must be moveable property, because otherwise the property

would be taxable in the situate State under paragraph (1).

On HMRC's interpretation of article 6(2), the Supreme Court could not see what the purpose of article 13(4) and (5) would be, because any payments in relation to hydrocarbons would be treated as a payment in respect of immoveable property and taxable under article 13(1).

Issue 3

Finally, the Supreme Court considered the interpretation of section 1313(2)(b) CTA 2009. The issue was whether the Payments were profits from "from exploration or exploitation rights" and therefore taxable under the domestic legislation. The Supreme Court found that the Payments did fall within the domestic legislation and so would have been taxable but for its conclusions in relation to the UK-Canada Convention.

The Court of Appeal had expressed doubt whether the Payments could be described as a benefit of the oil extracted. Both HMRC and the Supreme Court accepted that it was not enough for the Payments to be linked to the price of oil. However, because the Payments were linked not just to the price of oil, but

to the quantity of oil extracted and sold, the Supreme Court held that the Payments did arise out of some benefit of the oil.

Discussion

Beyond the narrow ratio of the Supreme Court's decision in relation to the proper classification of the Payments under the UK-Canada Convention, the court's comments in relation to the *Ramsay* principle merit a careful reading. At paragraphs 89 and 90, Lady Rose said:

> "**[89]** There are some statutory inroads to this general principle that the separate existence of different legal entities which can be tax resident in different jurisdictions is recognised and accommodated by the tax code. For example, the CTA 2010 provides for group relief whereby losses can be transferred between companies within the same group to offset profits made by a different company. But the companies are still treated as separate legal entities, and the surrendering company must consent to the claimant company using its losses.

Where an exception is made to the principle that every person, legal or natural, is a separate taxable entity with its own tax residence, the circumstances are carefully defined by the legislation without a general appeal to economic interests or to reality or to what is 'actually going on'.

[90] Beyond that, it is true that there has been a greater tendency of the courts to neutralise the effect of tax avoidance schemes by looking at the reality of a transaction to see whether it is a transaction that was intended to be caught by a particular taxing provision. The court looks at the transaction as a whole, ignoring the fact that it was effected by a series of pre-ordained separate steps which, if analysed individually, may arguably have fallen outside the charge. The *Ramsay* principle, recently discussed by this court in *Rossendale Borough Council v Hurstwood Properties (A) Ltd* [2021] UKSC 16, [2022] AC 690, explains when a

> court can to that extent focus on the reality of what is happening combined with a purposive interpretation of the taxing provision. No one here has suggested that the Ramsay principle has any application to the present facts and nothing in this judgment casts doubt on the efficacy of those principles where they apply. If the conclusion of the Illustrative Agreement between Sulpetro and Sulpetro (UK) was pre-ordained once the licence had been granted to Sulpetro (UK), that was because the UK Government ordained it and not because it necessarily suited the Sulpetro group."

Lady Roses stresses that her comments are not intended to undermine the efficacy of those principles "when they apply", but this appears to be an implicit departure from the comments of the Supreme Court in *Rossendale Borough Council* (which her Ladyship cites), which emphasised that the so-called *Ramsay* principle always applies, because it is simply a consequence of purposive interpretation and legislation must always be interpreted purposively: see *Rossendale Borough*

Council at paragraph 9. As the Supreme Court acknowledged in *Rossendale*, the effect of that purposive interpretation will vary according to the facts of each case, but will often result in the courts ignoring a pre-ordained series of transactions in determining whether a particular statutory description has (or has not) been met.

Therefore, despite Lady Rose's attempt to down-play her comments, it is difficult not to see this as a rowing back from the high watermark of *Rossendale Borough Council*.

Indeed, this difference in approach is aptly demonstrated by comparing the majority judgment to Lord Briggs' dissent. His Lordship accepts that "tax avoidance played no part in… the present case" (paragraph 127) but his starting point is nevertheless the famous dictum of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets* Ltd [2003] HKCFA 46, that:

> "The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

Lord Briggs identifies the purpose of article 6(2) UK-Canada Convention as granting a Contracting State the right to tax certain types of property that have a sufficiently close connection to that State, even if that property would not usually be considered "immoveable" as that term is normally understood. Lord Briggs decides that this purpose is engaged whenever income is received in consideration for the ability of another person to work natural resources situated in a Contracting State.

Turning to a "realistic view" of the facts, Lord Briggs says that Sulpetro's complete ownership of Sulpetro (UK) cannot be ignored. To the contrary, this fact forms the "bedrock" of a realistic view of the transaction as a whole. In his Lordship's view, Sulpetro must have been conducting the activities, because it incurred all the expense; it accepted all the risks and rewards of the work; it made all the decisions and it received immediate ownership over all the resources extracted. In disagreement with the majority judgment, saying that Sulpetro worked the Buchan Field "through its wholly owned subsidiary" is not a denial of the companies' separate legal personality, but merely acknowledging their relationship as parent and subsidiary.

Conclusion

Lord Briggs' dissent demonstrates how the Supreme Court could have undertaken a broad-brush *Ramsay* interpretation to determine the appeal, and makes it all the more noticeable that the majority chose not to do so. Instead, they favoured a more narrow, technical interpretation of the relevant provisions. In doing so, the Supreme Court may have begun to lay the groundwork for (yet another) quiet revolution in its approach to the *Ramsay* principle.

VAT ON HOLIDAY HOMES: DON'T BUY IT, BUILD IT

Alex Spencer

Introduction

It is nearly summer, so this article seasonably discusses holiday homes and their VAT treatment. Specifically, the article discusses a quirk of the VAT legislation which means that the purchase of a newly built holiday home is subject to VAT at the standard rate, but building one from scratch is not. Such are the intricacies of the fiscal theme park that is the VAT legislation.

Holiday homes

VAT is charged at the standard rate to purchasers of "holiday accommodation."[1]

A reasonable conclusion from the legislation is that anything you might be able to sleep in can be holiday accommodation if you think about it hard enough.

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[1] Item 1(e), Grp 1, Sch 9, Value Added Tax Act 1994 ('**VATA 1994**')

The definition "includes" (in no particular order of comfort) "any accommodation in a building, hut (including a beach hut or a chalet), caravan, houseboat or tent which is advertised or held out as holiday accommodation or as suitable for holiday or leisure use…"[2] HMRC expressly take the view in their public notice on the subject[3] that "accommodation" includes homes, flats, chalets and villas.

But the definition is wider still. The term also applies to any sale of a freehold or long (in England and Wales, greater than 21 years) leasehold interest in a dwelling which is subject to a restriction in its occupation throughout entire year or which cannot be the occupier's principle private residence.[4]

(Save a few) grand designs

However, if a person buys land and then employs a contractor to build a holiday home on it, the VAT

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[2] Note 13, Grp 1, Sch 9, VATA 1994.
[3] HMRC Public Notice 709/3 at Paragraph 5.
[4] Note 11, Grp 1, Sch 9, VATA 1994 in conjunction with Note 13, Grp 5, Sch 8 VATA 1994.

position is more favourable so long as the holiday home constitutes a dwelling.[5]

The purchase of the land will be exempt from VAT. If the land has historically been subject to an option to tax, that option will have no effect so long as the purchaser intends to use the land to build a dwelling for their own private use.[6]

The supply of building services by a contractor will be zero-rated.[7] If the contractor purchases and incorporates buildings materials into the building as part of the zero-rated construction services, those materials will be zero-rated too.[8]

BYOB: Bring your own building materials

For various reasons, the DIY builder may want to acquire their own building materials. It may significantly reduce the cost of the contractor's

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[5] Per note 2 of Grp 5, Sch 8, VATA 1994, a "dwelling" is self-contained living accommodation not directly accessible from any other similarly self-contained accommodation which is not subject to a restriction on its separate use or disposal, and which has been constructed in accordance with any statutory planning consent.
[6] Para 11, Schedule 10, VATA 1994
[7] Item 2, Grp 5, Sch 8, VATA 1994
[8] Item 4, Grp 5, Sch 8, VATA 1994

services. The contractor may be unwilling to take on the risk of purchasing the materials themselves. Whatever the reason, there is in these circumstances a potential VAT cost because building materials can only be zero-rated when they are supplied with zero-rated construction services.

However, the DIY builder can obtain VAT relief on building materials they have purchased themselves by making a claim under section 35 VATA 1994 (also known as the "DIY housebuilders Scheme") within six months of practical completion of the holiday home so long as the construction is "lawful" (in compliance with planning and building regulations) and carried out "otherwise than in the course of a business."

DIY won't HMRC accept my s 35 claim?

Of course, making a claim under s 35 VATA 1994 requires the DIY Housebuilder to get the VAT treatment correct. The scheme rules are complicated, but there are two particularly common difficulties.

First, the requirement that the construction be carried out "otherwise than in the course of the business" means that a scheme claim cannot be made if the constructor intends to let the holiday

accommodation (which is a business activity) or sell the property. This can be overlooked. If the housebuilder plans to do either, they should instead consider registering for VAT to recover VAT incurred on the build.

Second, and the most common source of difficulty in making a claim for VAT incurred on building materials under s 35 VATA 1994, is the definition of "building materials" itself. The statutory definition does not clarify anything: "goods of a description ordinarily incorporated by builders in a building of that description."[9]

The guidance on the meaning of the term reflects a long history of attempts by taxpayers to obtain the benefit of zero-rating for every conceivable item under the sun and it is not, as a result, intuitive. By way of illustration, HMRC's Public Notice 708:

- dedicates three paragraphs to a discussion of when a fitted wardrobe is a 'building material'

[9] Note 22, Grp 5, Sch 8, VATA 1994

(which depends on, amongst other things, the *view into the wardrobe*);[10]

- considers saunas and wind turbines, but not carpets, to be articles "ordinarily incorporated into a dwelling;"
- dedicates valuable paragraph-space to explaining that an oven cannot be considered a space-heater just because it heats up when it is turned on.

This pedantic part of the legislation causes real difficulties. For that reason, anyone intending to purchase building materials for use in a DIY housebuilding project should confirm before purchase that they will be eligible for VAT relief under s 35 VATA 1994.

Conclusion

Considering that VAT is a consumption tax, it might be considered unusual that the VAT legislation treats the acquisition of what is essentially the same consumer good as subject to different liabilities

[10] HMRC Public Notice 708, paragraph 13.5(c) "on opening the wardrobe you should see the walls of the building."

depending on how it is acquired. However, HMRC have long accepted as uncontroversial the more advantageous VAT treatment that building a holiday home confers on the DIY Housebuilder by comparison with someone who buys a holiday home outright.[11]

[11] Revenue and Customs Brief 29/10