

1 Settlements and Rental Income?

Recent experience suggests that HMRC is beginning to take a hard line when examining cases involving the transfer of rental properties, or the rental income arising, to limited companies as a potential income tax mitigation strategy.

Care should be taken to ensure that entitlement to rental income receivable by the company has been properly and legally transferred so that is clear that even if beneficial ownership of the property remains with the individuals concerned the entitlement to the rental income has itself been transferred over to the company. Where the property itself has been transferred this issue should not arise, (although capital gains tax issues might of course be a problem at the time of the transfer), but where the property is retained in personal ownership then the level at which the rentals to the individual from the company are set will be critical.

It will always be advisable to have obtained a professional valuation of the rental value of the property to support the figures being used and the rentals being paid.

Cases have been encountered where the HMRC argues that any significant differential in rents paid out from the company and rents it receives represents a “settlement” by the property owner on the company of the rental income as a means of mitigating income tax liabilities.

Can it be argued that any improvement expenses the company incurs on behalf of the property owner represent “consideration” payable by the company for the excess rental income it receives? This might raise more problems than it solves as HMRC might then argue for benefits charges, or S419 “loans or advances” charges.

The “settlements” legislation is now contained in ITTOIA 2005 SS 620 *et seq* and delegates are reminded that the definitions of settlement and settlor are deliberately wide and intended to be so:

S620 ITTOIA 2005 Meaning of “settlement” and “settlor”

(1) *In this Chapter—*

“settlement” includes any disposition, trust, covenant, agreement, arrangement or transfer of assets (except that it does not include a charitable loan arrangement), and

“settlor”, in relation to a settlement, means any person by whom the settlement was made.

2 Access to Private records in enquiry cases?

One feature of the new SA enquiries system which has been apparent from the earliest stages is that Inspectors now frequently request (demand?), access to clients' private bank accounts in detail in order to check entries on tax returns. This has caused and continues to cause considerable discussion and argument

The Revenue is of the view that a section 19A notice can, at least in theory, be issued for the production of such information. However the Inspectors instructions on dealing with enquiries contain clear instructions that this will not always be the case.

Where business receipts or expenses have been paid through the private account then the Revenue has a strong case for saying that the account represents part of the business records. Where this is not the case then there will probably be other ways of checking entries on the return.

HMRC's instructions indicate that the provisions of section 19A do not provide a blanket authority for access to such information and as such cases must be chosen on their own merits and where there is clear justification for asking for the information. It is not sufficient for the inspector to seek the private accounts simply because, for example, there is a monthly standing order from the business account for the proprietors drawings. This does not merit their provision.

It is therefore suggested that such requests should generally be resisted unless there is a clear case for the Revenue contending that the private accounts represent a part of the business records.

2.1 The link between Directors and their Companies?

The current trend in Corporate Enquiry cases is to deal with everything at once and in future it will be increasingly common to see both PAYE and CT audit work carried out in tandem. The Revenue is also increasingly likely to conduct enquiries on the company and the directors at the same time especially on close company cases.

However in many cases currently being seen inspectors appear to be seeking access to personal tax and financial information about the directors' personal affairs without going through the proper formalities. It is becoming increasingly common to see opening letters on company cases requesting access to personal information from the director and also to experience questions about the person side during the opening interview on a company enquiry case. Whilst both the client and the accountant/adviser will wish to be cooperative and constructive it is important to recognise that the statutory framework for personal and corporate enquiries are completely separate at the moment.

The Inspector does not have the authority to seek third party information from the company about the tax affairs of the directors at the outset of an enquiry. He must start an enquiry on these individuals personally if he wishes to do so and cannot strictly obtain tax details about their private affairs from their employer, even if it is

also their own company! Notices under section 9A TMA 1970 will need to be issued personally to each director before he can obtain this information.

The important point here is that the time limits and deadlines for personal self-assessment and company tax returns do not always run in tandem and the inspector must take great care to ensure that enquiry windows do not close on one whilst he is still working the enquiry on the other.

Secondly even if the Inspector does start an enquiry into the personal affairs of the directors he must still cross the “material inaccuracy” hurdle before he can obtain private account details etc. He must first check the tax returns, obtain the necessary verification of the entries thereon and only then if he has found that the business accounts are incorrect and that extraction can be shown is he likely to have a strong enough case to be able to demand access to the private information.