THE TAXATION OF EMPLOYEE CAR BENEFITS WHEN THE CAR IS JOINTLY OWNED

Keith M Gordon[1]

1 The High Court case of *Christensen (HM Inspector of Taxes) v Vasili*[2] seemed to mark the end of the road for a scheme that would allow employees to avoid (or at least reduce significantly) the tax charges on the benefit-in-kind of an employer-provided car. However, the judgment in that case suggests (not necessarily intentionally) that the scheme would have worked had it been implemented slightly differently.

2 This article considers the merits of such an argument and therefore whether the tax charge on employer-provided vehicles can indeed be avoided.

The legislative framework

3 Car benefits are taxed in accordance with the provisions of Part 3, Chapter 6 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"). That Chapter rewrote the provisions formerly within Part V, Chapter II of the Income and Corporation Taxes Act 1988 ("ICTA") with effect from 6 April 2003.

4 The essence of the provisions is set out in section 114(1) of ITEPA which reads:

> 114(1) This Chapter applies to a car or a van in relation to a particular tax year if in that year the car or van–

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2 [2004] EWHC (Ch) 476; [2004] STC 935

> (a) is made available (without any transfer of the property in it) to an employee or a member of the employee's family or household,
>
> (b) is so made available by reason of the employment (see section 117), and
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> (c) is available for the employee's or member's private use (see section 118).

5 The wording until 5 April 2003 was similar. Section 157(1) of ICTA read:

> 157(1) Where in any year ... a car is made available (without any transfer of the property in it) either to himself or to others being members of his family or household, and
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> (a) it is so made available by reason of his employment; and it is in that year available for his or their private use ....

The facts of *Vasili*

6 Mr Vasili was the majority shareholder and director of a company ("HMSL"). In 1997 and 1998, HMSL purchased two cars that were made available to Mr Vasili for his private use. However, between the date of HMSL's purchase of the vehicles and Mr Vasili's being able to use the cars, Mr Vasili acquired a 5% interest in both vehicles.

7 Mr Vasili argued that he could not be taxed under what is now section 114, because the car was not made available to him; instead, Mr Vasili's had a right to use the car because of his 5% stake in the vehicle.

8 The Special Commissioner who heard the original appeal agreed and held that there was no assessable benefit in kind under what is now section 114. However, he held that Mr Vasili was required to pay tax on the benefit of having the full use of a chattel, whilst owning only 5% (under what are now sections 203 and 205 of ITEPA, previously sections 154 and 156(5) of ICTA).[3]

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3 (2003) Sp C 377

The judgment in the High Court

9 Pumfrey J allowed the Revenue's appeal against the Special Commissioner's decision. He held, in paragraph 12, that one cannot cease to make a car "available" (within the context of section 114) by ensuring that the employee owns an interest in the vehicle.

> "I consider that the words 'made available (without any transfer of the property in it)' are not to be construed in a manner which has the result that the conferring of any interest upon the employee sufficient to give the employee an independent right to possess and use the asset is sufficient to prevent the car from being 'made available'."

10 In reaching this decision Pumfrey J noted that the wording of the statute made it clear that Parliament had not considered the issue of joint ownership. The Judge stated that, using ordinary language, the question "who made the car available to Mr Vasili" must be answered in the sense that HMSL did. Additionally, the statute (at section 132, formerly section 168D) provides that capital contributions made by the employee will reduce the taxable benefit-in-kind arising. His lordship held (at paragraph 15) that this provision applies when the capital contribution secures a part interest in the property as much as when no part of the ownership is transferred to the employee.

11 As a result, Mr Vasili was held to be liable to the tax arising under the benefits-in-kind legislation, with the proviso that relief was due in respect of the (capital) payments made by Mr Vasili to HMSL.

An alternative proposition

12 In many ways, the decision of the High Court was not surprising. Very few people (if any) would have said that Parliament would have intended the provisions relating to employees' cars to be side-stepped in the way Mr Vasili had hoped. And, presumably to the relief of the Inland Revenue, Pumfrey J was able to reach such a conclusion without stretching the words of the statute, even if a literal approach was not being adopted.[4]

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4 Nevertheless, it must be pointed out that the Judge's conclusions have not been received without criticism. For example, see James Kessler QC, *The Taxation of Foreign Domiciliaries,* 3rd Edition, 2004, pages 599 to 600. This article proceeds, however, on the assumption that a future Court would confirm Pumfrey J's judgment.

13 However, what is perhaps interesting is that the judgment appears to rely upon the fact that the car was bought *first* by HMSL with a share *then* being sold to Mr Vasili. As the Judge said, using "ordinary language" the car was "made available" to Mr Vasili by the company.

14 Additionally, Pumfrey J made no explicit comment on the meaning of "made available" within the legislation. The only comment made was that it had to cover cases where an interest in the car was transferred to the employee.

15 But there appears to be no reason why this should always be the case. For example, subject to having had the funds available, Mr Vasili might have purchased the cars outright and then sold a 95% interest to HMSL. Alternatively, Mr Vasili and HMSL could have jointly purchased their respective interests in the car.

16 In both of these latter situations, one would expect a Court to strive to reach the same conclusion as did Pumfrey J on the facts that were before him even though the wording of the statute, in my view, would be (even) less accommodating.

17 The two arrangements are now considered in turn.

Simultaneous purchase of respective interests

18 In such circumstances, it is my view that a Court which was not well-disposed to such tax-planning techniques would not hesitate to hold that, as with *Vasili* itself, the car (in some form or other) is being made available to the employee. Whilst it is true that the car is at all relevant times partially owned by the employee and that the employee consequently has the right to use the car, it is equally true that, in some sense, the "scheme"[5] permits a car to be made available to the employee.

19 However, the Inland Revenue would also need to show that this making available of the car to the employee were also "without any transfer of the property in it". In *Vasili*, Pumfrey J held[6] that the partial ownership of a car by an employee would not be sufficient for there to be the "transfer of the property in [the car]". Whilst his Lordship accepted that there is some force in the argument that one should read in the words

5 I am not intending to use this word in a disparaging way.

6 in paragraph 13 of the judgment

"any of" before "the property", it is my view that a Court, facing such an attempt to side-step the car benefit rules, would not rush to move from a literal reading of this part of the legislation where to do so would benefit the taxpayer who was evidently seeking to avoid a tax charge.

20 Thus, in my opinion, it would not be advisable for there to be a simultaneous purchase by the employer and employee

Purchase by employee followed by partial sale to employer

21 On the other hand, an employee would escape the benefits legislation if there were a full interval between his or her acquisition of the car and the sale of a share in it to the employer. This is because there would be no doubt that there is, at some time, the transfer of the property in the car to the employee, taking the situation outside that considered in section 114.

22 Of course, no such scheme can be considered without consideration of the House of Lords' recent decision in *Barclays Mercantile Business Finance Limited v Mawson*[7] ("*BMBF*") and the *Inland Revenue Commissioners v Scottish Provident Institution*[8] ("*SPI*").

23 For example, suppose that two alternative proposals are being considered. The first is an arrangement whereby an employee buys a car on day 1 with the payment of a 5% deposit with the employer purchasing (from the employee) a 95% stake on day 2 (by agreeing to pay the balance to the seller). The second is a case where there is an interval of a year between the employee's purchase of the car and the sale of an interest in the car to the employer. Practitioners will know that the first proposal would be viewed with more suspicion by the Inland Revenue than the second.

24 However, it is not the suspicions of the Revenue that matter at the end of the day. As emphasised by the House of Lords in *BMBF*[9]:

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

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7 [2004] UKHL 51

8 [2004] UKHL 52

9 at paragraph 36

25 On the other hand, *SPI* permits a Court to "have regard to the whole of a series of transactions which were intended to have a commercial unity". Nevertheless, there is nothing in the judgment that allows a Court to re-order the transactions that did take place so as to shoe-horn the facts into the legislative scheme. Thus a Court may not pretend that either of the two proposals outlined is directly comparable to the facts in *Vasili* (in particular, the fact that Mr Vasili bought his interest in the car from his employer).

26 Nevertheless, *SPI* makes it clear that it might still be appropriate for the Court to treat the employee's acquisition of the entire car and the subsequent sale of the part interest as part of a single composite transaction in which the employer and employee jointly purchase the car. This would be particularly in cases which, to use the wording of Lord Diplock from his speech in *Inland Revenue Commissioners v Burmah Oil Company Limited*[10], where these transactions form part of a "pre-ordained" series of transactions. On this basis, the first of the two alternatives referred to in paragraph 23 would risk being treated in the same way as a simultaneous purchase by employer and employee.

27 This leads one to the difficult question: what would constitute a safe time interval between the employee's purchase of the car and the subsequent partial sale to the employer?

28 Whilst it does not fully address the issue of what constitutes a pre-ordained series of transactions, as a rule of thumb, I would suggest that any interval would be sufficiently long if it allowed the car to devalue significantly during that period. The problem with this is that any such scheme would probably lose its appeal to employees.

Other possible lines of attack

29 Unlike the scheme entered into by Mr Vasili, the above proposal could involve the employer transferring money to the employee – that is if the two do not co-purchase the car. There may be a risk therefore that the Inland Revenue would seek to tax such a payment as the employee's earnings.

30 However, to do so, the Inland Revenue would need to show that the payment fell within the provisions of section 62 of ITEPA. That reads:

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10 1982 SC (HL) 114

62(2) In [the Employment income] Parts "earnings," in relation to an employment, means–

(a) any salary, wages or fee,

(b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or

(c) anything else that constitutes an emolument of the employment.

31 I would submit that none of these meanings would cover the situation envisaged – in particular the first paragraph does not seem relevant at all and the second would not seem to apply where there is no element of profit for the employee. The third paragraph would appear to be the most pertinent. However, it should be noted that this was included as a residual provision under the Tax Law Rewrite which was responsible for the new legislation and thus the paragraph ought to be given a very narrow reading. In view of the fact that the employee would be selling an interest in the car for its market value, I would submit that any such payment could not be an emolument of the employment.

32 Interestingly, the Inland Revenue could raise an argument under section 205. That section will apply if:

> "an asset [is] used wholly or partly for the purposes of the employee or a member of the employee's family or household; and
>
> there is no transfer of the property in the asset".

33 Section 205 was clearly intended to cover situations where an asset was owned by an employer (or other third party) and the employee had the use of it. However, the words, when read literally, seem equally valid in cases where an asset is first wholly owned by the employee and a share in it is transferred to the employer. However, such a result would be highly anomalous because section 205 makes no distinction between cases where the employee owns 95% of the asset (having transferred 5%) and the more conventional case where the employee owns the asset outright. For this reason, I would submit that section 205 would not apply in cases

where an employee buys a car and transfers a share in it to the employer.[11]

Conclusion

34 The "company car" provisions appear to have stood the test of time and they have resisted the attack from the scheme entered into by Mr Vasili. Whilst Pumfrey J's judgment appears to give a green light to some simple variants of Mr Vasili's scheme, it nevertheless appears that the provisions are strong enough to resist a further attack.

11 It will be recalled that Pumfrey J held that sections 203 and 205 did not apply in Mr Vasili's case (paragraph 11 of the judgment).