The 'Barter' System

Julie Butler warns of hidden evasion and lost reliefs

The rural community has thrived on the concept (and reality) of the system of 'barter' for centuries. In the majority of rural communities, most of the population has known each other for generations and a large number of the inhabitants are related to each other and with that comes trust (or bitter disputes – but let's concentrate on barter and trust).

It is quite normal for ferreted rabbits to be swapped at the local butchers' shops for pork chops, or for grazing to be exchanged for field maintenance. Hay bales can act as currency in return for building work, home-made cakes or repairs to vehicles. All very innocent, rustic and encourages a paper-free environment, but this can underpin what can only amount to potential income tax, corporation tax or VAT non-disclosure or even fraud.

'Contemporaneous' accounting records

That might sound harsh but it is the hard fact. The dream of a paperless rustic society has to be shattered when simple tax legislation and the self-assessment requirement to keep good books and records intervenes. The enquiry specialists will explain the need to keep 'contemporaneous' records.

Barter is not exclusive to the country communities – it is happening in the urban and suburban communities as well, for example painting and decorating work in exchange for motor repairs, or even building work in return for legal services. Another well-documented area is bartering in the advertising industry, where customers provide free advertising space to their suppliers. The opportunities are endless.

Market value and production of the sales invoice

Clearly the service or product provided must be recognised at market value *(Sharkey [HMIT] v Wernher* (1955) 36 TC 275) and a 'contemporaneous' sales invoice must be made out with sequential sales or fee invoice number and date. The business records must show how the invoice was settled, perhaps via a drawings journal or by the settlement of a purchase ledger invoice. Advice regarding the recording of such revenue is given in the Inland Revenue Booklet *Self-Assessment – A General Guide to Keeping Records*. To quote direct from the booklet:

> *'Even if you do not record these through a till, you will need to make a record at the time the transaction takes place of the goods taken or supplied and their retail selling price.'*

Entertainment

It is important here to refer to paragraph 45020 of the Inland Revenue's *Business Income Manual*, headed *Specific deductions: Entertainment: Expenditure which is not allowable*. This quotes:

> *'Expenditure on business entertainment is not allowable as a deduction against profits, nor may a deduction be made for any expenditure which is incidental to business entertainment .....*
>
> *'Traders may obtain entertainment through barter arrangements in which their own goods or services are exchanged for hospitality. The amount to be disallowed is the larger of:*
>
> *The value at which the transaction is recognised in the profit and loss account; and*
> *The cost of the goods or services exchanged for business entertainment.'*

Correct VAT treatment

The VAT invoices must not only be recorded in the correct VAT quarter but the correct amount of output VAT must be charged and reclaimed. There are actually bartering companies in the UK which offer bartering services to a whole range of businesses. This is a growing industry. Even in this complex corporate environment, the payment of VAT is always required.

Inheritance Tax (IHT) consequences

In the farming community (with the average age of a farmer being high) it is possible for (in all innocence) the majority of farming activities to be dealt with via a simple barter arrangement, for example grassland exchanged for farm maintenance. If the barter transactions are not reflected, the farm accounts might show almost no activity: how would this affect a claim for agricultural property relief (APR) under sections 115*ff*, *Inheritance Tax Act 1984*? Could it be proved that the land qualifies for APR or BPR? Could it be proved that the trade of farming was being undertaken?

Capital Gains Tax (CGT) consequences

What if part of the above farmland was to be subject to development? Would the land qualify for business asset taper relief (BATR) for CGT?

In order to claim Rollover Relief or Business Asset Taper Relief (this can lead to the magical 10% rate of Capital Gains Tax), it is essential to show that the farming assets are business assets, that is to say, assets used in the business. If all the activities are sheltered via barter, it is tricky to prove that the land is actually a business asset. If for example a parcel of the land were to become available for development, it could be very tempting for the Inland Revenue to challenge whether this is actually a business asset used in the business, because that is not supported by the business accounts and 'contemporaneous' records. This is another example where unrecorded barter could work against the taxpayer in the claim for reliefs.

IAS – What is the correct accounting treatment?

The Institute of Chartered Accountants in England and Wales summarise the accounting treatment under IAS 18 as follows:

> *'Revenue is measured at the fair value of the consideration received or receivable. The consideration is usually cash. If the inflow of cash is significantly deferred, and there is no interest or a below-market rate of*

interest, the fair value of the consideration is determined by discounting expected future receipts. If dissimilar goods or services are exchanged (as in barter transactions), revenue is the fair value of the goods or services received or, if this is not reliably measurable, the fair value of the goods or services given up.'

Further to this the International Accounting Standards Board interpretation SIC-31 *Revenue – Barter Transactions Involving Advertising Services* states:

'However, a swap of cheques, for example, for equal or substantially equal amounts between the same enterprises that provide and receive advertising services does not provide reliable evidence of fair value.'

Action by tax advisors

So what actions should be taken by tax advisors?

Clearly it is important to talk to clients to explain that undocumented and unrecorded barter is actually as dangerous and illegal as the 'black economy'. Explain that innocent barter can actually jeopardise future IHT and CGT reliefs by making it appear that there is no business activity where in fact, there is! Barter is found at all levels within our clients' activities and the key has to be client awareness.

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Finality and Discovery

In *Langham [HMIT] v Veltema* [2004] STC 544 a house, owned by a company, was transferred to the sole director, for no consideration. The company was controlled by the director and his wife. On his personal Tax Return the director declared a benefit-in-kind of £100,000, being the amount at which the house had been valued by an independent firm of Chartered Surveyors.

After the closure of the 'enquiry window' for the personal Tax Return, the company agreed with the Inland Revenue that, for the purposes of corporation tax on the chargeable gain, the house was worth £145,000 at the date of transfer. The question for the Court of Appeal was simply whether the Revenue were entitled to make a 'discovery' assessment, to bring the benefit-in-kind assessed on Mr Veltema up to £145,000.

Although the Revenue accepted that Mr Veltema had made a full and proper disclosure of all relevant information on his personal Tax Return, the Court of Appeal held that the Revenue was entitled to make a discovery assessment, because at the time the enquiry window closed, the Inspector responsible for considering the personal Tax Return had no reason to suppose that the £100,000 valuation was 'unreliable'.

The professional bodies protested that this reduced the self-assessment promise of finality to a will-o'-the-wisp. The Revenue issued a guidance note *Discovery Following the Veltema Judgment* in December 2004. The main points from this have now been republished in Statement of Practice SP 01/06 *Self-Assessment: Finality and Discovery*, in which HMRC attempt to reassure us that, 'in most cases', finality will be achieved where:

> The self-assessment is made on the basis of a valuation carried out by a qualified and independent person, who is named in the 'white space'; *or*
>
> The basis on which doubtful items have been dealt with (for example, drawing the line between expenditure on 'repairs' and on 'improvements') is made clear in the white space.

But only 'in most cases', for valuations may still be challenged where associated taxpayers are affected by the same valuation (as in *Veltema* itself), and the Revenue believe they are entitled to base a 'discovery' for an earlier year on the findings of an enquiry into a year within the enquiry window (an example may be the 'discovery' that an incorrect method of stock valuation has been used).

Most importantly, the Revenue also restate their belief that they can make a discovery assessment if they couldn't see the wood for the trees – that a taxpayer has provided so much information that the Inspector could not reasonably have been expected to read it all. Damned if you do and damned if you don't .....

📖 *The full text of the new Statement of Practice is available for downloading from www.hmrc.gov.uk/practitioners/sp01-06.pdf.*