Field Court Tax Chambers

FCTC Digest

21st Edition (July 2024)

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EDITORIAL

Patrick Soares

Welcome to the 21st Edition (July 2024) of the FCTC Digest and the 10th year of the founding of Field Court Tax Chambers.

We have some special treats in store for reader in this edition.

The first article by the editor looks at what taxpayers are doing ahead of the major changes proposed on and from 6 April 2025 **when domicile as a tax connecting factor is to be abolished along with the remittance basis of assessment**. These changes will revolutionalise the tax code: it will be seen other countries (from Italy to Dubai) are more than happy to welcome the fleeing UK non-doms. It is possible the Labour government will see the light and water down the proposals but we shall see.

The second article is by the Silk for the stars **Patrick Way KC** on the new **HMRC guidance on football agent's fees and dual representation contracts** of 13 May 2024. This is an extremely informative article and Patrick provides a **seven key points check list.**

The third article is by **David Southern KC** who looks at seven cases which act as the **sign posts of the UK tax system**. This is a very enjoyable and essential read.

The fourth article by **Riya Bhatt** looks at what is to be done if a dwelling is held in a company (i.e. there is an **enveloped dwelling**) – should the situation be left or should the company be liquidated. There are many points to be considered – the ATED, IHT, shadow directorships, CGT, SDLT and others. Riya sets out the points to be taken into account. This is an essential read for practitioners who have to deal with this dilemma – **should I or shouldn't I?**

The fifth article is by **Alex Spencer**. It looks at the legislation in the Finance No 2 Act 2024 passed to close the "gap" in the transfer of assets code which was exposed in the Supreme Court by the decision of **Fisher v HMRC** (where the transferor is a company). The anti-gap legislation is widely drafted and gives rise to some surprising results: some changes go to the heart of the transfer of assets code.

It is not possible to advise on the code without getting to grips with this gap-filler provision.

The final article is by **David Tipping**. It looks at the IHT question of whether a settlor who is not a beneficiary under a settlement has nevertheless **reserved a benefit under the settlement** just because he is capable of being added in as a beneficiary. The systematic analysis is a joy to read. The article may give **a lifeline to some taxpayers.**

Patrick C Soares

FCTC

DOMICILE AND REMITTANCE BASIS CHANGES FROM 6 APRIL 2025 – WHAT ARE TAXPAYERS DOING?

Patrick C Soares

1 The Budget 2024

1.1 In his Budget of 6 March 2024 The Chancellor announced some revolutionary tax changes with effect from 6 April 2025.

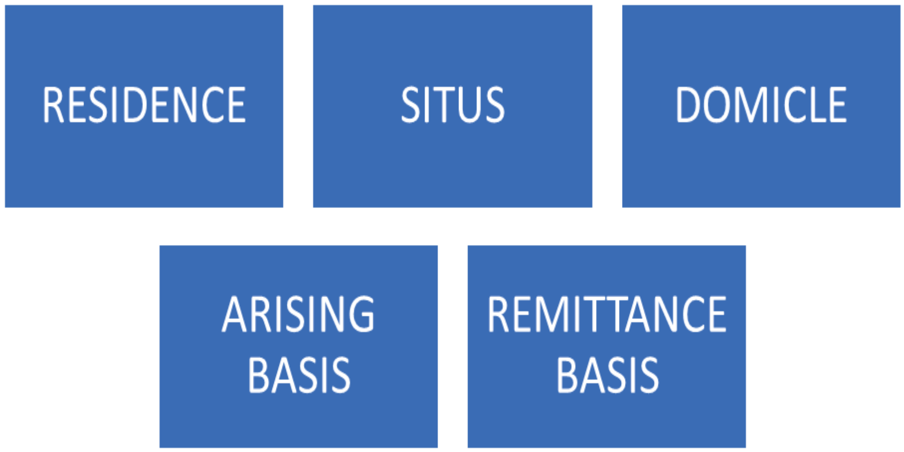
1.2 The general election was on 4 July 2024 and we have a Labour government.

1.3 This article deals with what taxpayers are doing in practice following the publication of the proposed changes.

2 Abolition of remittance basis of assessment

2.1 At the heart of the tax code there are five things: residence, situs (or source or location) and domicile and the arising and remittance bases of assessment.

2.2 Five building blocks of the tax system – two are to go: domicile and the remittance basis of assessment



2.3 From 6 April 2025, the remittance basis of taxation will be abolished along with domicile as a tax connecting factor.

2.4 Also from 6 April 2025, the protection from taxation on *future* income and gains as they arise within protected trust structures (golden trusts) (whenever established) will be removed.

2.5 These are revolutionary changes although the use of domicile as a tax connecting factor has been chipped away at over the years.

2.6 Many parts of the tax code will have to be revised to cater for these changes. Pity the draftsman.

3 The 4 year “FIG-LEAF” tax holiday

3.1The remittance basis will be replaced from 6 April 2025 with a new 4-year foreign income and gains (FIG) regime for individuals who become UK tax resident after a period of 10 tax years of non-UK residence.

3.2 Thus if an individual has not been resident in the UK for a period of 10 years or more and then becomes resident in the UK he will benefit from the FIG regime for a period of 4 years.

Example

3.4 Mr X a lawyer from Italy comes to the UK for the first time to work in the UK office for a 4 year stint. He benefits from the FIG regime

3.5 If he has been non-UK resident for less than ten years and becomes UK resident he gets no tax free FIG holiday for any of the 4 years.

3.6 The individual will not pay tax on FIG arising in the first 4 tax years after becoming UK tax resident and will be able to bring these funds to the UK free from any additional charges.

3.7 Thus if an individual takes up residence in the UK for the first time he has a four year tax free FIG holiday.

3.8 *His FIG income and gains are tax free whether or not remitted to the UK*. He also will not pay tax on non-resident trust distributions.

3.9 The individual will pay tax on UK income and gains, as is the case for non-domiciled individuals now. There is no change in that respect.

3.10 Individuals who on 6 April 2025 have been tax resident in the UK for less than 4 years (after 10 years of non-UK tax residence) will be able to use this new regime for any tax year of UK residence in the remainder of those 4 years.

<u>Example</u>

3.11 Y a German accountant came to the UK in February 2024: he is resident in 2023/24 and 2024/25 and he is on a remittance basis. For 2025/26 and 2026/27 he is on the FIG basis; he has the income tax exemption and CGT exemption (and has the ten year IHT exemption until 2033/34).

4 End of the golden trust regime

4.1 From 6 April 2025, the protection from taxation on *future* income and gains as they arise within trust structures (whenever established) will be removed for all current non-domiciled and deemed domiciled individuals who do not qualify for the new 4-year FIG regime.

4.2 FIG arising in non-resident trust structures from 6 April 2025 will be taxed on the settlor or transferor (if they have been UK resident for more than 4 tax years) on the arising basis.

4.3 This is the same basis on which trust income and gains are taxed on UK domiciled settlors or transferors under the current regime.

4.4 Thus capital gains may be assessed under s86 on the settlor even though he and his spouse may be excluded from benefit, if for example their children are beneficiaries.

4.5 Under the present rules the golden trust regime eliminates any s86 charge but that status is to go from 6 April 2025.

4.6 If the settlor and spouse are excluded from benefit that is normally enough to take the trust out of an arising basis charge for income tax purposes.

5 Capital Gains Tax and the IHT consultation

Capital gains tax

5.1 From 6 April 2025, an individual who is not, or who later ceases to be, eligible for the new 4-year FIG regime will be taxed on foreign gains in the normal way.

5.2 Transitional rules will apply for individuals who have claimed the remittance basis and are neither UK domiciled nor UK deemed domiciled by 5 April 2025. If, on or after 6 April 2025, they dispose of a personally held foreign asset that they held at 5 April 2019, they will be able to elect to rebase that asset to its value as at 5 April 2019. This rebasing will be subject to conditions that will be set out later.

5.3 The taxpayer may make a disposal before 6/4/25 to say an underlying company to realise gains before the new regime comes into operation.

IHT consultation

5.4 The IHT consultation will deal with the design of a new residence based system to apply from 6 April 2025. There are a number of detailed issues and interactions that will be consulted on, such as transitional provisions, the length of the residence criteria and tail provision, any connecting factors other than residence, gifts with reservation, domicile elections, formerly domiciled residents and calculation of trust charges. Labour will have their own ideas.

5.5 It is likely that for 10 years of UK residence a new arriver will not pay IHT on non-UK located assets (provided the new arriver has been non-UK resident for the previous 10 consecutive years). It is unclear how years of UK residence will be counted for IHT purposes – is it ten consecutive years or ten out of the last 15 years. This is easier than the current system which requires going back 15 out of 20 years i.e. prior to April 2013. He also has the 4 year FIG period. After four years the new arriver will be subject to tax on all income and gains on the same basis as all long term UK residents i.e. on an arising basis. Trust income and gains of trusts set up by a new arriver settlor are exempt in the four year period. Benefits received from the trust are tax free in that period.

5.6 After ten years of UK residence the new arriver will be subject to IHT on his or her worldwide estate wherever domiciled from April 2025. Also they will remain within the IHT net for the following ten years after becoming non-UK resident (called the 10 year tail).

6 SO WHAT ARE TAXPAYERS DOING?

6.1 Change of government

It is unlikely the Labour government will introduce a less harsher regime than that proposed by the Tories but it is possible (now that the electioneering is over and financial realities have to be faced). So some taxpayers are applying a wait and see approach.

6.2 4 Year FIG tax free holiday

It seems to the writer that the 4 year FIG tax free holiday is attractive for overseas people coming to work in the UK for a 4 year stint but it does not help the long term resident non-doms who are used to being taxed on a benefits basis on their golden trust's foreign income and the trust gains.

6.3 Golden trusts

Trusts where the settlor and the spouse of the settlor are excluded from benefit may not be affected by this new regime: the income is taxed on the beneficiaries on a benefits basis. Gains made by such trusts however may be taxed upon the settlor under the harsh TCGA 1992 s86. An underlying company may however avoid such charges (TCGA 1992 but note s3 and s3A).

6.4 Certain trusts unaffected

Taxpayers will be requiring reports on how their trusts will fare under the new regime – the 3 main types will be (1) trusts where the settlor and/or spouse are beneficiaries and (2) children's trusts where they are excluded from benefit and (3) trusts where the settlor has died.

6.5 Sections 3 and 3A TCGA 1992 company

A taxpayer may have set up a Jersey protected trust under which he or she is a beneficiary with a foreign underlying company which holds all the trust assets.

If the CGT avoidance defence is available then gains made in the underlying company will not be taxed on the settlor under the new proposed regime.

6.6 Old Income and gains to be kept separate

Gains realised before 6/4/25 and income arising before that date in a golden trust should be kept separate.

6.7 Onward gifts regime

This will remain for old income and gains (pre-6/4/25). Under this regime appointments from trusts to non-resident beneficiaries (who then make gifts to UK resident beneficiaries) to wash the trust's gains and income are countered under *inter alia* TCGA 1992 s87I.

6.8 Harsher regime for s87 trusts

Trusts within TCGA 1992 s87 are taxed on a benefits bases and that should continue. There is some concern the regime may be made harsher so gains can be taxed in UK resident beneficiaries when realised by the overseas trust but that is unlikely.

6.9 UK trustees – think the unthinkable

Note in some cases the best route may be to appoint UK trustees as this will not have any adverse effects for IHT purposes.

6.10 Break residence under the unique SRT rules

In future the writer suspects taxpayers will concentrate on ensuring they are not UK tax resident under the statutory residence test which has many quirks of its own; they may work abroad under a full time overseas contract of employment or attend UK board meetings by Zoom. Some taxpayers fearing the worst have adopted the non-residence approach: over time a taxpayer can end up spending up to 120 days in the UK and not be resident.

6.11 Alternative regimes

Other foreign regimes are attractive especially Italy for wealthy individuals. It is possible the UK/Italian treaty where the tax on death *may* be 4% may override the 10 year tail provisions if the taxpayer becomes resident in Italy. Italy is certainly an attractive regime as well as Monaco and to a lesser extent Portugal. In the Middle East, Dubai and Saudi Arabia are proving attractive.

6.12 Exit charges

There is some concern that an exit charge may be imposed on individuals who become non-UK resident. There are already charges on company and trust exits and on individuals in limited circumstances.

6.13 Inheritance tax – 10 year rule

It is likely that after 10 years of residence a taxpayer will be fully within the IHT regime.

6.14 Inheritance tax - trusts

Trusts set up before 6 April 2025 may come out relatively unscathed under the proposed (Budget) new IHT regime but it is very likely Labour may impose a more harsher regime and this concerns many taxpayers. If they had created an excluded property settlement after being resident in the UK for 10 years of more will it take 10 years of non-residence to take the settlement out of any new IHT regime?

6.15 Intermediate settlements

Some taxpayers may create excluded property settlements before 6 April 2025, taking a chance on how the new regime will pan out.

6.17 Gains washed

Taxpayers may considered realising gains within golden trusts (they may transfer the assets to an underlying company for example) before the new regime comes into effect on midnight 5 April 2025.

6.18 Trust breaks

Some taxpayers are breaking their trusts with the funds being appointed to non-resident family members – they need to take into account the third party 3-year gift rules.

6.19 Safe trusts

Some overseas companies may be outside the transfer of assets code (ITA 2007 s720 et seq) because for example the motive defence applies. This means the foreign income arising to a foreign company is not taxable unless is it paid out as a dividend.

Such taxpayer must ensure no transactions are entered into which take away the motive defence which must be proved for the setting up of the structure and any associated operations and other transactions set out in ITA 2007 s720A.

6.20 Non-sterling UK accounts

Section 157 IHTA 1984 specifically excludes from IHT accounts denominated in a non-sterling currency where they are held by a non-UK domiciliary who is also not UK resident. This is useful for individuals who have left the UK. They often have all kinds of reasons for wanting to continue to use their long-standing UK banks. Also offshore accounts can in practice be quite time-consuming and difficult to set up. Hopefully this relief will remain.

6.21 Treasury gilts

IHTA 1984 S6(2) gives excluded property status to certain securities issued by the Treasury.

Thus a taxpayer who leaves the UK can sell assets free of CGT and buy gilts as protection during the 10 year IHT tail period (perhaps he can settle the same). Hopefully this regime will remain. In some instances HMRC feel DOTAS may be in issue.

6.22 A long term winner

Taxpayers who may benefit from the regime are those who left the UK more than 10 years ago and now return – they benefit from the 4 year FIG regime and the 10 year IHT regime. These taxpayers known as FDRs (formerly domiciled residents (IHTA 1984 s272)) are considered a particularly unfortunate group of taxpayers: under the new regime they may not be able to believe their luck!

NEW HMRC GUIDANCE ON FOOTBALL AGENTS' FEES AND DUAL REPRESENTATION CONTRACTS[1]

Patrick Way KC

Speed read

HMRC's default approach, in relation to the taxation of an agent's fees where the agent is acting for both an acquiring club as well as a footballer (i.e. dual representation), is now to treat, in principle, any fee paid by the club to the agent as giving rise to a benefit in kind charge (subject to tax) in the hands of the footballer. This charge is by reference to the proportion of the agent's fees paid by the acquiring club which may be said "really" to be paid for the benefit of the footballer and not for the benefit of the club.

HMRC's new guidance of 13 May 2024 "Help with Football Agents' Fees and Dual Representation

[1] This article has appeared in the June/July issue of HMRC Enquiries, Investigations and Powers published by Armstrong Media and also on LawInSport website.

Contracts"[2] *provides further detail on this approach, and states (broadly speaking) that they now need specific evidence to depart from their new "default position" which is that a football agent is acting exclusively for a player.*

It seems likely that a great deal of evidence will now be needed to dispel HMRC's starting assumption that everything the agent does is for the exclusive benefit of the footballer (rather than the footballer and the club).

This article examines HMRC's new guidance, looking at:

- HMRC's evolving view on dual representation;
- why are HMRC placing the burden on the player?;
- an example of the problem;
- what do HMRC want to see to evidence genuine dual representation?;

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[2] **Help with football agents' fees and dual representation contracts, 13 May 2024,** https://www.gov.uk/government/publications/help-with-football-agents-fees-and-dual-representation-contracts-gfc6/help-with-football-agents-fees-and-dual-representation-contracts (last accessed 13 June 2024)

- how does this work in practice?;
- is HMRC's new approach fair?

HMRC's evolving view on dual representation

On 13th May 2024, HMRC issued a publication entitled "Help with Football Agents' Fees and Dual Representation Contracts".

This publication has "upped the ante" in relation to the taxation of football agents' fees.

Background

A short history may help provide context.

July 2009

In July 2009, the Football Association added a new regulation (to go with their existing regulations) by which they allowed dual representation by agents[3] so that a football agent can represent both a player and a club during the same contract negotiations, provided that the representation arrangement is agreed to by all parties.

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[3] https://acrobat.adobe.com/id/urn:aaid:sc:eu:a95605e6-0697-4003-acb9-b9a69e4af4fa

Accordingly, as a broad proposition HMRC does recognise the concept of dual representation. What they do not accept, however, is that the split of the agent's fee, between player services and club services, can default to 50:50. Indeed HMRC's current view is that the football agent will typically be working more or less *exclusively* for the player to place them (or keep them at) their preferred football club and to secure the best terms possible. So the player is treated by HMRC as having a tax bill (by reference to the benefit in kind rules) for all the fees charged by the agent to the club unless evidence to the contrary can be produced.

March 2021

It was not always like this. Indeed up until the issuing of previous guidance on 31st March 2021, HMRC widely accepted that fees payable in respect of dual representation were equally split (50:50) between the player and the club so that the player would be responsible for tax on 50% of the total fees but not the remaining portion which would be attributed to services provided by the agent to the club.

However, with effect from 31st March 2021, as the guidance issued at that time, stated:-

> "HMRC does not accept a default split (e.g. 50:50). Instead it expects an evidenced and commercial justification for payments made."

January 2024

On 1st January 2024, the FA's Football Agent Regulations came into force and superseded the previous Working with Intermediaries Regulations. HMRC expect that all parties will follow these Regulations and they accept that the Regulations do not impose any restrictions on agents representing more than one party during a transfer.

As will be seen from this article, however, HMRC do not accept the default split of 50:50 between club and player services. Instead, HMRC will require evidence and a commercial justification for the payments that are made.

May 2024

As foreshadowed above, on 15th May 2024, HMRC published new guidelines for compliance aimed at football agents and clubs which set out their view on dual representation contracts.

The essence of the new guidelines is that HMRC's view is that agents work primarily for the player and fees for the agent's services should be apportioned accordingly – with the lion's share (if not all) being treated as payments for services provided to the footballer exclusively: so a significant benefit in kind charge results in the hands of the player.

Why are HMRC placing the burden on the player?

The football world has seen an explosion in the quantum of fees paid to agents.

For example, according to Sky Sports[4] the late football agent, Mino Raiola, was paid £24m for brokering the transfer of Paul Pogba from Juventus to Manchester United in the summer of 2016. At the time Juventus's general manager, Giuseppe Marotta, said (at the club's AGM in October 2016) as follows:-

4 https://www.skysports.com/football/news/11667/10632115/paul-pogbas-agent-mino-raiola-made-gbp24m-from-transfer-to-manchester-united-say-juventus#:~:text=England-,Paul%20Pogba's%20agent%20Mino%20Raiola%20made%20%C2%A324m,to%20Manchester%20United%2C%20say%20Juventus&text=Paul%20Pogba's%20agent%20Mino%20Raiola%20was%20paid%20%C2%A324m%20for,Manchester%20United%20in%20the%20summer

> "The price tag [for Pogba] we asked was €105 m (£94m) plus €5m (£4.5m) bonus in the case that the player renews his contract with the club or is sold for more than €50m (£44.7m).
>
> We made around €95m. Mino Raiola, his representative, will be paid €27m (£24m). The profit on Pogba is around €72m (£64.5m)."

Further, according to The Athletic[5], Manchester City spent over £51.5m on agents' fees for the 2022-23 season and, if you would like to see how much your club spent on agents, you can look at the schedule to this article.

An example of the problem

HMRC's May 2024 guidance explains the problem identified by HMRC succinctly by reference to an example that they have produced showing the difference between an agent acting for a player on the one hand and the same agent acting for the transferee

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5 https://www.nytimes.com/athletic/4368905/2023/03/31/agents-intermediary-fees-2022-23/

club in relation to the same transaction, on the other.[6]

Agent acting for player	**Tax impact**
Agent's fee	£1m
Amount paid to agent plus VAT	£1.2m
Income tax on player £1.2m at 45%	£540,000
Employer's Class 1A National Insurance Contribution £1.2m at 13.8%	£165,600
Club cannot reclaim VAT	£200,000
Total tax	£905,600

Agent acting for club	**Tax impact**
Agent's fees	£1m
Amount paid to agent plus VAT	£1.2m
Income tax on player	£0
Employer's Class 1A National Insurance Contribution	£0
Club can claim VAT	£200,000
Total tax	£0

[6] See Footnote 1

So you can see why the stakes are high, in terms of analysing the tax treatment of transactions involving substantial payments made to agents.

What do HMRC want to see to evidence genuine dual representation?

HMRC do accept that there can be circumstances where there may be genuine dual representation and in these circumstances HMRC expect to see a comprehensive audit trail and documentation to demonstrate the true contractual and commercial value of the relationships involved.

The documentation and evidence must be retained to support any claims to the effect that the value of the services (to any extent) is for the benefit of the club rather than the player.

In particular, HMRC say in their May 2024 Guidance that they would expect to see the following:

- the player-agent representation agreement;
- permission given by the club holding the player's registration to the potential buying club to approach the player and

their agent, when the potential buying club wishes to recruit that player;

- the potential buying club's initial approach to the player and the player's agent, including any terms offered to the player and agent;
- the club's request for:
    - the agent to provide the club with services;
    - the specific services the club requires the agent to provide to the club;
    - the amount the club would be content to pay to the agent in return for those services;
- the agent's agreement to enter into a dual representation contract, including the types of services to be provided, the initial terms on which any such agreement was negotiated, and the final terms agreed — this information should also make clear the valuation that the agent itself placed on its services to the player and club respectively;

- the player's agreement to enter into a dual representation contract;
- the dual representation contract between agent, player and club;
- the player's agreement to enter into an employment contract with the club, including initial terms on which any such agreement was negotiated, as well as the final terms agreed.

Continuing with HMRC's guidance of May 2024, it is to be noted that HMRC would expect this evidence to be obtained *before* the agent provides their services. The only exception to this is the player's agreement to enter into an employment contract with the club as, logically, the agent will have provided their services beforehand. HMRC say that if they see dual representation documentation dated on the same date as the player's employment contract, then they regard that as an indicator that the values attributed to the player and the club may not reflect the commercial reality.

HMRC also expect all relevant evidence to be kept, and the sort of evidence which they are looking for is documentation to show that the services provided by the agent are consistent with what was originally agreed.

This evidence can include:-

(a) emails;

(b) contracts;

(c) letters;

(d) faxes;

(e) memos;

(f) meeting notes;

(g) notes of telephone calls;

(h) text messages (including WhatsApps);

HMRC, not surprisingly, want all the evidence to be retained.

Also within the May 2024 Guidance HMRC say that they would expect the agent to *separately* invoice the player and the club, and for those invoices to show in detail what the services were.

Further, HMRC state, within the May 2024 Guidance, that the type of services they would accept as being ‘club services’ can vary. They would expect dual representation contracts to be part of a club's or agent's internal tax assurance processes. They would also expect all parties to have confirmed with each other that they have given the same values to any split of player and club services when submitting returns to the relevant tax authorities.

Finally the amounts of outputs and output tax on the agent's VAT return, which relate to club services, should match the amount the club has reclaimed on its VAT return, subject to normal VAT exceptions.

How does this work in practice?

The first observation to make is that football transfers move fast and very often do not occur until deadline day. So to get all the information which HMRC want to see in place beforehand can be challenging. Nevertheless the relevant parties should do their best, at the very least, to agree beforehand that there is dual representation contract and what the terms are. In addition, as mentioned above, extraneous contemporaneous evidence is very helpful. So notes of telephone discussions and texts and WhatsApps will be very useful, for example.

Is HMRC's new approach fair?

As can be seen there has been a big shift by HMRC from a 50:50 split being acceptable, to the possibility of none of the services being provided for the benefit of the club with a large tax bill for the player as a result under the benefit in kind rules.

In my experience, however, there can certainly be scenarios in which a substantial benefit is provided to the club.

One example, based on a case which I have seen, may illustrate this.

In this instance a well-known footballer was happy to continue to play in Italy, but at that time the Premier League was growing in stature and the amounts which Premier League clubs would pay for footballers to join them was increasing astronomically. The particular player had no special interest in leaving Italy but if he was going to do that then he would have been happy to go to any club in one of the top leagues which would include the Spanish League and the English Premier League.

Offers were received for his services from a well known Spanish club but then, at the last minute, an English club moved in at a time when they were building a team which they hoped would be “world beaters”.

It made no difference to the footballer whether he stayed in Italy, went to Spain or went to England. The agent involved spoke to the English club and spoke to the Spanish club. In the end, without any prompting from the football agent, the English club offered 50% more by way of a transfer fee over and above what the Spanish club were offering. The transferring Italian club preferred therefore to accept the offer from the English club and asked the player if he would be prepared to move to the English club. The English club offered terms to the player on a “take it or leave it” basis (i.e. the football agent was not involved in negotiating those terms) and as a favour to the transferring Italian club (with whom the footballer had a good relationship) the player agreed to move to the English club: the Italian club thereby obtaining a larger transfer fee for itself. The English club rewarded the agent on the basis that they felt that the services in question were for their own benefit because they were successful in securing the footballer. The agent did not negotiate on behalf of the player and, indeed, as mentioned all the terms were agreed beforehand.

In this scenario, one can see that virtually none of the agent's services (perhaps none whatsoever) were provided for the benefit of the player. The player could have stayed in Italy or gone to Spain but simply went to the English club as a favour to the Italian club. *So why should there be a benefit in kind charge, of any substantial amount, in the hands of the player?*

Nevertheless, notwithstanding what seems to be a clear example of an agent providing services exclusively for a club HMRC are still of the view that there is dual representation because they are firm that that is their default position. So notwithstanding the strong facts here HMRC will still not concede readily.

For the future – in this sort of situation – there would need to be a full representation contract disclosed to HMRC and all of the information provided as described above. If, however, the matter were to go to trial then the evidence of the parties (particularly under cross examination) can be helpful. Nothing, however, will be better than contemporaneous evidence. See, for example, the guidance of Leggatt J (as he then was) in *SGPS S v Credit Suisse (UK)*

Limited [2013] EWHC 3560 at paras.15-22, in particular at para.22:-

> "In the light of these considerations, the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose – though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her

> recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

So there is no substitute for written documentary evidence and that is the message that HMRC have given in the May 2024 Guidance and generally. However, in my experience judges do like to see witnesses give evidence in front of them and so, in my experience, temper their judgment by reference to how persuasive the witness may be under cross-examination.

One can see that where transfers happen at the last minute it may be difficult to marshal everything in full compliance with the guidelines, but all reasonably practicable steps should be taken to do so, as promptly as possible. Agents should make sure that they have dual representation contracts ready but, as mentioned, this could be complicated if they are "jumping around" from one potential transferee club to another in the run in to deadline day. *Notwithstanding the logistical difficulties that may be produced HMRC will want to see a separate dual representation contract for each potential transferee club and therefore that is the main* *message of this article and of HMRC's guidelines*. After all, if one wishes to minimise the potential aggravation of a dispute with HMRC, having all the evidence available and producing it to HMRC is going to be critical and this includes having a dual representation agreement which sets out in full the agreement between the relevant parties including in particular the nature of the services of agent. This agreement should be entered into before the transfer negotiations begin.

Conclusion

HMRC are, in my view, subjecting football transactions and agents' roles in them to close scrutiny, and are approaching this matter from the starting point that virtually all of the services of an agent are provided for the benefit of the player and not the club. This gives rise to significant tax issues in the hands of the player and therefore if this risk is to be minimised the terms of HMRC's guidelines must be carefully considered and adhered to in practice. The key points to remember are:-

- the dual registration contract should be entered into as a first step – before negotiations with the club have started;

- contemporaneous evidence as to the agent's services is absolutely vital;
- in this respect the agent's services should be spelt out in the documentation particularly if it is to be argued that the transferee club is receiving more than 50% of the agent's services;
- record how the initial approach was made – did the transferee club approach the agent or were they on the receiving end of an approach from that agent?;
- get the documentation together as soon as possible so that there can be evidence as to what the agent was going to do before the transfer took place ideally;
- keep everything that records the various discussions involving the club, the player and the agent and in this respect be ready to keep things such as WhatsApp messages;
- invoice the player and the club separately and do so in accordance with the documentation mentioned above.

The schedule

Premier League agents/intermediary fees 2022-23[7]

- AFC Bournemouth – £5.05m
- Arsenal – £16.7m
- Aston Villa – £15.6m
- Brentford – £5.56m
- Brighton & Hove Albion – £8.58m
- Chelsea – £43.16m
- Crystal Palace – £9.79m
- Everton – £13.54m
- Fulham – £8.75m
- Leeds United – £15.31m
- Leicester City – £10.28m
- Liverpool – £33.69m
- Manchester City – £51.56m
- Manchester United – £24.72m
- Newcastle United – £10.78m

[7] 'Premier League agents/intermediary fees 2022-23', nytimes.com, last accessed 13 June 2024, https://www.nytimes.com/athletic/football/premier-league/

- Nottingham Forest – £4.35m
- Southampton – £6.31m
- Tottenham Hotspur – £16.13m
- West Ham United – £12.03m
- Wolverhampton Wanderers – £6.18m

SEVEN DIRECT TAX CASES WHICH EVERY SCHOOLCHILD SHOULD KNOW

David Southern KC

Standards of education in UK schools are constantly improving. To further this progress, the weekly Tax Corner which is held in chambers recently focussed on seven direct tax cases, knowledge of which should be added to the school curriculum.

Great Western Railway Co v Bater 8 TC 231

One of the central issues of tax is whether workers should be classified as self-employed or employees. The whole edifice of IR35, whereby individuals styled as self-employed contractors must be taxed as employees, revolves around this issue. Swathes of broadcasters who have for many years claimed self-employed status have fallen foul of these provisions.

The importance of the distinction lies largely in the manner in which income tax is collected and accounted for. If an individual is an employed earner, his employer must deduct and account for PAYE income tax and primary Class I NIC on his employment earnings. The work of tax assessment and collection is largely performed by the employer. If he is classified as a self-employed earner, he accounts for income tax and Class II NIC under self-assessment.

It has not always been so. In the nineteenth century both the self-employed and private employees were liable to income tax on the same basis, under Schedule D. Only holders of 'public' offices and employments were liable to tax as employees under Schedule E, with the consequent liability of the employer to deduct and account for tax on their earnings. Taxation under Schedule E was taxation at source.

The issue of the Sch E/Sch D frontier was not a serious problem before the First World War. Most lower-paid workers were outside the tax system. However, the First World War increased the relative wages of skilled workers; all pay increased by reason of inflation; the threshold at which income tax was charged was lowered; and rates of tax were increased.

Since then there has been a great shift from taxation on a self-employed basis to taxation on an employed basis. The great landmark in this process was *GWR v Bater*.

The full title of the case is important.

Great Western Railway Company, on behalf of W.H. Hall, Clerk to the Great Western Railway Company v Bater (Surveyor of Taxes)

The public title makes it clear that this was an assessment under Sch E by the Special Commissioners on GWR in respect of the income of Mr W.H. Hall. Mr Hall's annual salary of £130 as a fourth grade clerk for the tax year 1917/1918 under Schedule E, Rule 3.

Mr Hall and the GWR said he was liable to tax under Schedule D. The Inland Revenue Commissioners (IRC) said he was liable to tax under Schedule E. It was fortunate for Mr Hall that the assessment was made on the GWR as employer, because this meant that GWR paid all the costs of the appeal up to the House of Lords.

Section 6 of the Finance Act 1860 had expanded the scope of Schedule E, by extending its application to employees of railway companies. The question was, did this expansion bring in all employees of railways companies, or only those employees of railway companies who were holders of 'public' employments?

The policy which motivated the IRC was to shift the burden of tax administration and collection on to GWR. As Lord Sumner noted in the House of Lords at 251:

> *'The object of section 6 of the Act of 1860 is plain enough. It is to throw on the railway company work which would normally be performable by the officers of the Inland Revenue.'*

In the High Court Rowlatt J defined public offices and employments as (8 TC 231 at 235):

> 'an office or employment which was a subsisting, permanent, substantive position, which had an existence independent from the person who filled

> it, which went on and was filled in succession by successive holders.'

Railway companies had directors, engineers and senior executives, who held grand offices which were 'public' employments. They also had legions of humbler individuals, many of whom would be paid weekly wages rather than an annual salary.

The House of Lords held that Mr Hall's status did not permit his employment to be designated as 'public' in the sense used by Rowlatt J. As Lord Sumner put it at 252, '*To say that Mr Hall holds "an office" seems to me an abuse of language*'.

This decision caused consternation in the Inland Revenue, whose interest lay in the efficient collection of income tax, rather than in preserving social status. The Royal Commission on Income Tax in 1920 had recommended that all employments should be shifted to Sch E, and this was accomplished by FA 1922, s 18. This shifted from Sch D to Sch E the profits and gains accruing to any person from an office, an employment or a pension. The adjective 'public' which had caused so much confusion since 1842 was omitted.

Edwards v Bairstow 36 TC 207

It is a basic principle of most legal systems that appeal is only possible on a point of law. Findings of fact are made by the first instance tribunal, and are unappealable. On matters of fact, the court of first instance is also the court of last instance.

In most jurisdictions the distinction between fact and law is flexible. In English law, the distinction is unusually sharp. This is due to the circumstance what until 1933 most civil cases were decided separately by juries who decided the facts, judges who decided the law. Juries did not give reasons for their decisions. The question was often: did the jury believe the witness's evidence? Hence the principle that jury decisions are inscrutable and unchallengeable.

The special authority accorded to jury findings was one of the issues in *GWR v Batey*. There was no jury in that case, but in tax cases the Commissioners who hear appeals (and since 2009 the First-tier Tribunal) function as both judge and jury. The Special Commissioners found that Mr Hall did hold a public office or employment, and so came within Schedule

E. The Inland Revenue argued that this was a finding of fact, and so unchallengeable.

The House of Lords held that the finality of findings of fact should not be overstated. As Lord Atkinson said at 214 of the Special Commissioners:

> *'Their determinations of questions of pure fact are not to be disturbed, any more than are the findings of a jury, unless it should appear that there was no evidence before them upon which, as reasonable men, they could come to the conclusion to which they have come.'*

In any case, the Special Commissioners' conclusion depended on the true construction of Rule 3, which was a conclusion of law and therefore appealable.

Appeals for error of law are 'reasons appeals': *Lloyds TSB Equipment Leasing v R & C Comrs* [2014] STC 2770. Sometimes the misdirection may not be clear on the face of the decision, but may be inferred, so that the decision too unsafe to be allowed to stand.

Where is the line of sand to be drawn between matters of fact and matters of law?

Edwards v Bairstow notably extended the ability of the higher courts to hear appeals against findings of fact in tax cases, where a finding of fact constituted a disguised error of law.

What the court said in *Edwards v Bairstow* was that the conclusion of the fact-finding tribunal had to be reasonable. The barrier to appeal was significantly lowered.

Viscount Radcliffe delineates three ways in which a decision may be unreasonable.

- No evidence to support the determination
- Evidence inconsistent with and contradictory of the determination
- One in which the true and only reasonable conclusion contradicts the determination

This 'irrationality' ground for challenging a decision overlaps with the familiar grounds for judicial review. In both cases it is necessary to respect the institutional capacity of the original decision-maker.

Tribunals, Courts and Enforcement Act 2007 gives a number of powers to the tribunals and other courts, including a power to the Upper Tribunal to make *'such findings of fact as it considers appropriate'* where it sets aside and remakes the decision of the FTT: s 12(4). However, this fact-finding power only operates where an error has been made on point of law by the lower court.

In *R & C Comrs v Pendragon* [2015] STC 1825 Lord Carnwath at [44] – [51] noted the 'extended jurisdiction' of the UT in cases where error of law on the part of the FTT had been established. Thus, in some cases it may be that the UT may adopt a more flexible approach to error of law, going beyond *Edwards v Bairstow*.

Odeon Associated Theatres Ltd v Jones 48 TC 257

Commercial accounts and tax accounts are different. *Odeon Associated Cinemas* is the locus classicus which establishes the relationship between the two, and when the tax accounts can differ from the commercial accounts.

Odeon acquired cinemas with deferred repairs which did not affect their commercial value or profit-generating capacity. When the company was able to get round to doing the repairs, the IRC said it was capital expenditure, the company claimed it was revenue.

One reason why the Crown's case failed was the cinema company presented accounting evidence that its accounting treatment was correct, whereas the Revenue relied on what they regarded as general legal principles.

What the court said was that the law uses accountancy profit as the basis for business taxation. This is a matter of fact. But the law must have the last word in determining what is the true profit, having regard to accounting principles: as Pennycuick V-C said at 273:

> *'At the end of the day the Court must determine what is the correct principle of commercial accountancy to be applied. Having done so, it will ascertain the true profit of the trade according to that principle, and the profit so ascertained is the subject of taxation.'*

This was confirmed by Bingham MR in *Gallagher v Jones* [1993] STC 537 at 555-556 where he observed of *Odeon:*

> *'it seems to me to define with great clarity the task on which the court is engaged and the way in which it should set about it ... I find it hard to understand how any judge-made rule could override the application of a generally accepted rule of commercial accountancy which (a) applied to the situation in question, (b) was not one of two or more rules applicable to the situation in question and (c) was not shown to be inconsistent with the true facts or otherwise inapt to determine the true profits or losses of the business'.*

So that identifies the three circumstances in which the commercial accounts may be overruled for tax purposes:

- Where there is a statutory override
- Where two or more correct accounting

rules may be applied

- Where the accounting result is inapt to determine the ‘true’ profits of the business.

The mantra of the 1990s was that tax follows the accounts. Cases falling in the third category will consequently be rare. What happens increasingly, however, is that the bridge from accounting to tax is broken by a special rule.

Ransom v Higgs [1974] STC 539

Taxation is a wholly statutory basis. That goes back to the principle of the Bill of Rights of 1689 that taxation can only be imposed on subjects by laws passed by Parliament, and that such laws should be limited in duration to one year. Hence our annual finance acts.

However, some of the key concepts used in tax statutes are common law concepts. The applies in particular to the concept of ‘trade’, the profits of which are taxable but is not defined in the legislation.

The essence of the case law definition is to be found in *Ransom v Higgs*.

The case involved an immensely complex scheme for sheltering the profits of land development from tax through what was called 'stock stripping'. After 1969 its tax saving effect would have been negated by the artificial transactions in land legislation.

The Special Commissioners made a finding of fact that the whole scheme had been planned in advance on the basis that it would be executed as a whole: '*the whole of the transactions were planned in advance on the basis that they would be executed as one whole'* (552).

After 1981 that finding would also have put an end to any hoped-for tax saving. However, in 1974 times were different.

The orchestrator of the scheme was Mr Higgs. The Inland Revenue sought to cut through the tangled mass of transactions by arguing that this constituted trading by Mr Higgs and that he should taxed on the profit ultimately realised.

The House of Lords held that whether or not an activity constitutes a trade, may be

(i) a question of fact and degree *('it is for the fact finding body to decide on the evidence whether a line is passed'* (553),

(ii) a question of '*recognition whether the characteristics of trade are sufficiently present'*

The House of Lords found against the Revenue on ground (ii), namely, that organising financial transactions could not constitute trading. All the companies and trusts involved were acting at the behest or under the direction of Mr Higgs. Trading required a bilateral relationship between a trader and a customer, who have a degree of independence from each other. As Lord Wilberforce explained (553):

> *' Trade involves, normally, the exchange of goods, or of services, for reward ... Trade presupposes a customer ... trade must be bilateral – you must trade with someone'*

This argument has been successfully deployed by HMRC is numerous film scheme cases in the past decade, on the grounds that the arrangements in question involve financial engineering, and this cannot constitute trading.

W.T. Ramsay Ltd v IRC [1981] STC 174

1979 was a time of low morale in the Inland Revenue. Inflation of up to 32% a year had eroded earnings. The terrible twins Tucker & Plummer appeared to be running rings round the Revenue. The courts, it seemed, did not to know how to cope. District Inspectors were allowing scheme cases to go through without challenge, because they felt out of their depth, faced with the notorious ingenuity of tax advisers.

However, it is always a mistake to under-estimate tax authorities. Like Russia, they are never so weak or so strong as they appear. In the background, moves were afoot. In particular, articles were being ghost-written in *British Tax Review*, and appearing under the names of distinguished barristers. The theme of these articles was that where a number of inter-connected steps were taken as part of a tax avoidance scheme, and there was no practical likelihood that they would not be carried through as a single arrangement, the tax effects of the separate steps would be assessed together. In *Floor v Davis* [1978] STC 436 Eveleigh LJ held that where A sold shares to B Co, and B Co sold on the shares to C Co, the two transfers could be regarded as a single integrated transaction.

This became what Lord Wilberforce in the House of Lords called 'the American argument', based on *Gregory v Helvering,* and the jurisprudence of Judge Learned Hand. It was propounded by the barrister, Peter Millett QC.

In the Revenue the *Ramsay* decision was regarded as the arrival of the US Seventh Cavalry. At a stroke it seemed that the dragon of artificial tax avoidance schemes had been slain.

That was not how it worked out. In the 1990s and 2000s a host of schemes were launched, chiefly involving film production but also based on intellectual property, which were highly artificial and did not make commercial sense unless the hoped for tax advantages were available. The reasons why these arrangements were thought to be outside *Ramsay* were threefold: (i) they had an element of commerciality; (ii) the decision in *Craven v White* was interpreted as sanctioning their tax-saving effect; (iii) they uniformly involved non-recourse loans, and the law was ambiguous as to whether non-recourse loans were in a real sense loans with a commercial basis.

When these schemes reached the tax courts, in almost every case they were held to be ineffective to achieve the hoped-tax saving, either on *Ramsay* grounds or because of their internal shortcomings.

Mallalieu v Drummond [1993] STC 665

The limitation of tax deductibility to expenses '*wholly and exclusively incurred for the purposes of the trade'* goes back to 1806.

Taxation of income predated the ordinary principles of commercial accounting' so it was necessary to have tax rules about permissible deductions.

Most newly qualified barristers who go into practice probably claim the cost of wig and gown as revenue expenses. That is wrong. It is capital expenditure.

Ann Mallalieu, the last fox-hunting Labour peer, did not make that mistake. But she claimed in the tax year 1977/1978 the replacement and dry cleaning of black court dress as a business expense.

In *Bentley, Stokes and Lowless v Beeson* solicitors claim the cost of their individual lunches when meeting clients for business purposes. That was allowed on the grounds that (i) the test of business purposes was subjective, (ii) the incidental personal benefit was not a purpose of the expenditure, it was a consequence.

In Ms Mallalieu's case the evidence was that she only bought and used the black clothes for business purposes. General Commissioners held that the expenditure had a dual purpose, business and personal (ordinary clothing), and that disqualified the deduction.

The High Court allowed the appeal on the basis that the purpose was a business purpose, and the personal benefit was a consequence, not a purpose. The Commissioners had confused purpose and incidental effect.

The problem about subjective purpose is that it rests on the unsupported ipse dixit of the taxpayer. There was no external evidence of purpose, other than the circumstances of the trade and the statement of the taxpayer that the sole motive was to comply with the business requirements.

In the House of Lords Lord Brightman raised the floodgates argument. He concluded that, while the purpose test was subjective, a person could have unconscious motives. While Ms Mallalieu's only conscious purpose might be to provide for professional requirements, the clothes also provided for general human requirements, such as warmth and decency, and this also must have been a factor in determining her purpose in incurring the expenditure. In any case, there is an argument that a person wills the inevitable consequences of their actions.

The motive/purpose test is subjective/objective. The question is, when will the personal/subconscious motive be downgraded from a purpose to an effect?

Vodafone Cellular Ltd v Shaw [1997] STC 734

The answer to that question was given in *Vodafone Cellular*. In the early days of mobile 'phones, Vodafone entered into licensing agreements for the benefit of two subsidiaries. It turned out that the group had no use of the licence rights. Accordingly, Vodafone paid a lump sum under a fee cancellation agreement. It claimed a revenue deduction for the expenditure. This was refused on the grounds that (i) this was capital expenditure; (ii) it was incurred for the benefit of the subsidiaries' trade, not the trade of Vodafone; (iii) the purpose was to benefit the trade of the group as a whole.

All these arguments were thrown out by the Court of Appeal in a virtuoso judgment of Millett LJ (as Peter Millett QC had then become).

He held that '*the object of the taxpayer in making the payment must be distinguished from the effect of the payment'* (742). The primary inquiry was to ascertain the particular object which the directors sought to achieve by the payment. Once that question had been answered, its characterisation as a trade or private purpose was a question of fact, appealable only on

Edwards v Bairstow grounds. The fact that in considering the commercial benefit to the company of the payment the directors also had regard to the interests of the trade of the group as a whole did not exclude the deductibility of the payment at the company level. The group benefit was an effect, not a purpose.

TAX CHARGES ON ENVELOPED PROPERTIES

Riya Bhatt

Introduction

An enveloped property is a property owned through an entity such as a company or a partnership where one of the members is a company.

Such structures were common before 2017 as a form of Inheritance Tax planning, whereby non-UK domiciled individuals would own UK-situated property through a non-resident company to avoid falling within the ambit of UK Inheritance Tax.

Since 6 April 2017, through amendments to the Inheritance Tax Act 1984 ("**IHTA 1984**") made by the Finance (No 2) Act 2017, such structures are no longer effective at allowing UK residential property to fall outside the scope of inheritance tax. This is because the definition of "excluded property" for the purposes of IHTA 1984 was amended such that shares in a company, even if non-UK resident, which owned an interest in UK residential property was no longer “excluded property” and was instead subject to UK inheritance tax.

As a result of this change in the legislation, many people considered, or may still be considering, “de-enveloping” their properties and removing the corporate vehicle as the owner of the UK residential property.

This article considers the tax consequences of properties enveloped in a non-UK resident company and the tax charges imposed if such properties are “de-enveloped”.

Note these structures should be reviewed in any event following the domicile changes proposed from 6 April 2025, although the changes are unlikely to have any significant impact on such structures.

Tax charges on enveloped properties

If a non-UK resident corporate vehicle or partnership with a corporate member owns UK property, a number of tax charges may arise.

Annual Tax on Enveloped Dwellings

The annual tax on enveloped dwellings ("**ATED**") applies to UK and non-UK companies and was introduced through the Finance Act 2013 ("**FA 2013**"). The ATED imposes a charge to tax pursuant to s.94 FA 2013.

Section 94 FA 2013 imposes a charge to tax where a company is entitled to an interest in a single dwelling which has a taxable value of over £500,000.

In other words, the ATED is charged in a year if on any one day in the year a company owns UK residential property worth over £500,000.

Pursuant to s.102 FA 2013, the property's value is taken to be its market value on a "valuation date". A "valuation date" is updated every five years; the first fell on 1 April 2012, and every five years following, a new valuation date occurs. A "valuation date" can also be the date of acquisition of the single-interest dwelling or the date of a disposal of part of the single-interest dwelling (s.102(3) FA 2013).

Relief from the ATED charge may be available. For example, there is a relief from ATED if the property is rented out to an unconnected third party on a commercial basis, or is being prepared to be rented out, under s.133 FA 2013. Relief is also available where the property is open to the public for at least 28 days per year. The reliefs can be found in ss.133-150 FA 2013.

Corporation Tax

Section 5(2) of the Corporation Tax Act 2009 ("**CTA 2009**") states that non-UK resident companies are also liable to corporation tax on UK property income.

If the company carries on a UK property business, it will be liable to corporation tax on the profits of that business pursuant to s.5(2)(c) CTA 2009.

A "UK property business" is defined in s.205 CTA 2009 as consisting of:

(a) Every business which the company carries on for generating income from land in the United Kingdom, and

(b) Every transaction which the company enters into for that purpose otherwise than in the course of such a business.

This means that if a non-resident company owns UK property and rents it out, it will be liable to corporation tax on the profits it makes from that activity.

In addition, if the company sells the UK property, it will be subject to corporation tax on the gain made from the property pursuant to s.2B(4) of the Taxation of Chargeable Gains Act 1992 ("**TCGA 1992**").

<u>Inheritance Tax</u>

Inheritance tax is charged on the value transferred by a chargeable transfer (s.1 Inheritance Tax Act 1984 ("**IHTA 1984**")). As stated in s.2(1) IHTA 1984, "chargeable transfers" are defined by reference to "transfers of value". Section 3(2) IHTA 1984 provides that a transfer of value does not include a transfer of "excluded property".

"Excluded property" is defined in s.6 IHTA 1984. This section was amended pursuant to Schedule 10, paragraph 3 of Finance (No 2) Act 2017, and it now states that s.6 IHTA 1984 is subject to Schedule A1 IHTA 1984.

The amendment to s.6 IHTA 1984 and the introduction of Schedule A1 IHTA 1984 essentially (for the purposes of this article) focuses on circumstances where a non-UK domiciled individual owns an interest in an overseas company (which is a close company), and the value of the individual's interest in the close company is directly or indirectly attributable to residential property in the UK (i.e. the value of the shares in the company comes from UK residential property because the assets owned by the company includes UK dwellings).

In those circumstances, the individual's interest in the overseas close company is not excluded property under s.6 IHTA 1984.

As a result, transfers of value of such interests in overseas close companies are, from 6 April 2017, not excluded by virtue of s.3(2) IHTA 1984 and <u>are</u> subject to UK inheritance tax.

This means that if a shareholder of an overseas company which owns UK residential property makes a chargeable transfer of the shares in that overseas company, UK inheritance tax will be charged on that transfer, even if the shareholder and transferee are non-UK resident or domiciled.

Potential charges on de-enveloping

In order to de-envelop the UK property, it may be decided to wind-up the overseas company. The tax charges on such a winding-up will be as follows.

Corporation tax

When a company is wound up and its assets are distributed between its shareholders, corporation tax is payable on the gain realised by the company through the disposal of the property to the shareholders: s.2B(4) TCGA 1992.

Where the property is distributed *in specie* on the company's liquidation, the disposal of the property is treated by s.17(1) TCGA 1992 as taking place at market value.

As stated in Schedule B1 TCGA 1992, the value of the property will be rebased to 5 April 2015. As such, corporation tax will be charged on the gain realised on the property between its market value on disposal and its value on 5 April 2015.

Capital Gains Tax

In addition to the corporation tax charge on the company on its winding up, CGT will be charged on the shareholders. Section 122 TCGA 1992 has the effect that where a company is wound up and its shareholders become entitled to receive capital distributions from the company, the shareholders shall be treated as if they had disposed of an interest of the shares in the company.

As a result, shareholders of an overseas company which owns UK property will be deemed to have disposed of their shares when the company is wound up.

Section 1A(3)(c) TCGA 1992 states that a person who is not UK resident is liable to CGT on the disposal of assets which derive at least 75% of their value from UK land.

This means that where a shareholder is deemed to have disposed of their shares in a non-resident company whose only asset, for example, is a UK property, the shareholder will be liable to CGT on that deemed disposal.

As per Schedule 4AA TCGA 1992, CGT will be payable on the difference between the value of the shares on 5 April 2019 and the value on the date of disposal.

There is, therefore, a double CGT charge on the winding up of a property-rich company. First, the company will be required to pay corporation tax on gains derived from the value of the property under s.2B(4) TCGA 1992. Second, the shareholders of the company will be subject to CGT on the deemed disposal of their shares under s.1A(3)(c) TCGA 1992.

SDLT

For present purposes, SDLT is chargeable on transfers of land and is charged on the consideration paid by the buyer.

If, when the overseas company is wound up and its assets are distributed, the shareholders assume liability for the company's debts, there will be a "chargeable consideration" for SDLT purposes as per paragraph 8, Schedule 4 Finance Act 2003.

The amount of debt assumed by the shareholders will be considered as “chargeable consideration” such that an SDLT charge will arise.

A common example might be where an overseas company owns UK property which is subject to an outstanding mortgage. If the company distributes that property to its shareholders on winding-up and the mortgage remains unpaid, the shareholders will have assumed the mortgage debt of the company. The amount of the mortgage will be treated as the chargeable consideration paid for the property by the shareholders.

In SDLTM04042, HMRC accept that no consideration will have been given where (i) the company is debt-free, and (ii) where any debt owed by the company is owed solely to the shareholder.

Inheritance Tax

The inheritance tax position will remain the same both before and after de-enveloping the property. This is due to the effect of Schedule A1 IHTA 1984 which prevents shares in an overseas company owning UK property from being excluded property for IHT purposes. As such, even when the company is wound up, an IHT charge will arise on a chargeable transfer of the property.

Is it worth de-enveloping?

Given the potential tax charges highlighted above which may occur on de-enveloping a property, one might consider whether it is worth de-enveloping at all.

Indeed, the only real disadvantage of continuing to keep the UK property within the corporate structure is the charge to ATED if none of the exceptions apply, and corporation tax if the property is rented out. Inheritance tax charges may also be an issue if a shareholder in the overseas company transfers his shares to his children, for example.

However, the likelihood is that these tax charges will not be in point at the same time. For example, if the property is rented out to an unconnected party such that the company falls within the charge to UK corporation tax under s.5(2) CTA 2009, it will not fall within the ATED simultaneously because the relief contained in s.133 FA 2013 will apply.

Equally, if the property is not rented out, there will be no corporation tax charge on the overseas company but there may be an ATED charge if none of the other reliefs apply. There may also be a benefit in kind charge, for example if the property is used by a shadow director within s.67 of the Income (Earnings and Pensions) Act 2003.

In contrast, the charges on de-enveloping may be significant, especially if the shareholders take over any mortgage that the UK property is subject to.

Of course, it is likely that the property will need to be de-enveloped at some point, anyway. However, if the UK property is sold by the company before winding up, or is distributed as a dividend before winding up, a tax saving may be achieved. Both those situations will prevent the double CGT charge on both the company and the shareholder, as the latter will not be charged to CGT on the deemed disposal of their shares in the company and only the company will bear a corporation tax charge.[1]

[1] Note if the shareholder is UK resident, a charge under ss. 3 and 3A TCGA 1992 may be in point.

Conclusion – ATED v SDLT

For those considering whether to de-envelop their UK properties owned by overseas companies, it seems that the tax disadvantages of doing so outweigh the advantages unless it is important to save SDLT. The shares in the company can be sold free of SDLT, but if the property itself is sold the SDLT can be as high as 17% which makes some properties highly unattractive to sell.

If the ATED is not in issue there is an attraction in keeping the property in the company for SDLT purposes.

‘GAPS WHEN THEY ARE FOUND IN OUR TAX LAWS ARE USUALLY SPEEDILY FILLED’– NOTES ON SECTION 720A (AND SECTION 727A) OF THE INCOME TAX ACT 2007

Alex Spencer

Introduction

In the 2024 Spring Budget, the government undertook to introduce anti-avoidance legislation responsive to a perceived gap in the Transfer of Assets Abroad (‘**TOAA**’) code, contained in Chapter 2 of Part 13 of the Income Tax Act 2007 (‘**ITA 2007**’) and identified by the UK Supreme Court’s decision in *Fisher v HMRC* [2023] UKSC 44.

The ‘gap’ identified by the government was that the TOAA code did not, in the Supreme Court’s view, apply to transfers of assets abroad made by close companies in circumstances where the transfer had been procured by that company’s shareholders. That arguably presented an opportunity for individuals to use companies to transfer assets abroad and so avoid a charge to tax under the TOAA code which they would otherwise suffer were they to transfer the same assets themselves.

S 22 of Finance No 2 Act 2024 (‘**F(2)A 2024**’) accordingly inserted sections 720A and 727A into ITA 2007. Each section modifies a different provision of the TOAA code. S 720A ITA 2007 expands the scope of the charge imposed on an individual transferor’s ‘power to enjoy’ income in s 721 ITA 2007. S 727A expands the scope of the charge on the recipients of capital sums connected with a transfer in s 728 ITA 2007.

This article provides some general commentary on points of interest in the new provisions. S 720A and s 727A ITA 2007 are identical and so, for the sake of brevity in what follows, references to and comments on s 720A ITA 2007 can be applied equally to s 727A ITA 2007, but only s 720A ITA 2007 will be referred to. All references are to ITA 2007 unless otherwise specified.

The legislation

S 22 of F(2)A 2024 states:

> ***Other measures***
>
> **22 Transfers of assets abroad**

(1) Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) is amended as follows.

(2) After section 720 (charge to tax on income treates as arising under section 721) insert –

"720A Transfers by closely-held companies

(1) The charge under section 720 also applies for the purpose of preventing the avoiding of a liability to taxation by means of a relevant transfer carried out by a closely-held company in which an individual has a qualifying interest.

(2) But the charge only applies in those circumstances if—

(a) the individual is involved in the company, and

(b) the avoidance condition is met.

(3) An individual has a qualifying interest in a closely-held company if

the individual, or a nominee of the individual, is a participator in—

(a) the closely-held company, or

(b) the first closely-held company in a chain of two or more closely-held companies where each company in the chain is a participator in the next company in the chain, of which one such company is the closely-held company that carried out the relevant transfer.

(4) For the purposes of this section, an individual with a qualifying interest in a company is to be treated as being involved in the company unless the individual satisfies an officer of Revenue and Customs that neither the individual nor (in a case where the individual is not the relevant participator) the relevant participator has any direct or indirect involvement in the decision making of the company.

(5) The avoidance condition is met if—

(a) the relevant participator did not object to the making of the relevant transfer, and

(b) it is reasonable to draw the conclusion, from all the circumstances of the case, that the relevant participator was aware, or ought reasonably to have been aware—

(i) of the transfer, and

(ii) that one of the direct or indirect consequences of the transfer is the avoidance of a liability to taxation.

(6) For the purposes of subsections (4) and (5) the "relevant participator" means—

(a) in a case where the individual's qualifying interest arises as a result of a nominee of the individual being a participator in a company, the nominee, or

(b) otherwise, the individual.

(7) Any arrangements to secure that a person has no direct or indirect involvement in the decision making of a company are to be disregarded if the main purpose, or one of the main purposes, of the arrangements is to secure that the condition in subsection (2)(a) is not met.

(8) Any arrangements that would result in the avoidance condition not being met are to be disregarded if the main purpose, or one of the main purposes, of the arrangements is to secure that the avoidance condition is not met.

(9) In this section—

"arrangements" include any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable);

"taxation" has the meaning it has in section 737."

(3) After section 727 (charge to tax on income treated as arising under s 728) insert –

“727A Transfers by closely-held companies

…[1]”

(4) In section 721(1), after “720(1)” insert “or 720A(1)”.

(5) In section 728, after “727(1)” insert “or 727A(1)”.

(6) After section 719 (meaning of “associated companies”) insert –

“719A Other definitions

In this Chapter—

“closely-held company” means—

(a) a close company for the purposes of the Corporation Tax Acts (see Part 10 of CTA 2010), or

[1] The full provisions of s 727A are omitted because they are identical to s 720A.

(b) a company that would be a close company if section 442(a) of CTA 2010 were ignored (non-UK resident company not to be treated as close);

"nominee", in relation to an individual, means a person—

(a) who possesses any rights or powers on behalf of the individual, or

(b) who may be required to exercise any rights or powers on the individual's direction or behalf;

"participator" is to be construed in accordance with section 454 of CTA 2010."

...[2]

[2] Subsections 7 and 8 provide for restrictions to HMRC information gathering powers under the provisions of the TOAA code which are not of direct relevance to the subject matter of the present article.

(9) In section 751 (the tribunal's jurisdiction on appeals), before paragraph (a) insert—

> *"(za) section 720A(4) or 727A(4) (whether individual treated as involved in closely held companies"*

(10) The amendments made by this section have effect in relation to income arising on or after 6 April 2024.

Definitions

s 719A borrows definitions from Part 10 of the Corporation Tax Act 2010 ('**CTA 2010**'). A closely held company for the purposes of s 720A is a company <u>either</u> under the control of five or fewer participators or participators who are directors (s 439(2) CTA 2010) <u>or</u> of which five or fewer participators or participators who are directors possess or are entitled to acquire rights entitling them to the greater part of the assets of the company on its notional winding up (s 439(3) CTA 2010).

'Participator' has the same wide meaning it has in s 454 of Part 10 of CTA 2010. It encompasses:

- Any shareholder or someone entitled to acquire shares <u>or</u> voting rights
- Any loan creditor
- Any person entitled to participate in or receive distributions from the company or loan premia (on redemption of a loan), or any person entitled to acquire a right to do so.
- Any person who is entitled 'to secure' that present or future income or assets of the company will be applied directly or indirectly for their benefit.[3]

<u>Two observations</u>

S 720A does not itself create a new charge but rather expands the scope of the existing charge in s 721(1). S 721(1) has been amended to charge to tax income which is treated as arising 'to such an individual as is mentioned in s 720(1) <u>or s 720A(1)</u> in a tax year for

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[3] For a discussion of whether a beneficiary of a discretionary trust might be considered a participator in a company held by the trust, and so fall within the new TOAA provisions, see 'Mind the Gap! Extension of the Transfer of Assets Abroad legislation post-Fisher' in Tax Journal, issue 1657, 14.

income tax purposes…' Under the new provisions, as before, it is the individual who in consequence of the transfer has the power to enjoy income arising to another person abroad who is charged, not the company.

The charge applies to all income arising on or after 6 April 2024, not simply income arising in consequence of transfers taking place after that date. The CIOT Briefing Paper[4] on the provisions notes that they are therefore, in a sense, retroactive. Income arising to an individual on or after 6 April 2024 will necessarily have arisen in consequence of transfers which took place before that date and which were not, prior to the introduction of the legislation, within the scope of the concept of a relevant transfer.

The purpose of the provisions

S 720A(1) expresses the purpose of the provisions. As noted above, the legislation is a response to the Supreme Court's reasoning in *Fisher* that the TOAA code did not apply to transfers procured by

[4] See 3.1 of the Chartered Institute of Taxation's briefing paper on Clause 22 of the Finance Bill: Finance Bill - Clause 22. March 30 2024.pdf (kc-usercontent.com)

individuals through close companies. However, the Supreme Court in *Fisher* (at [87]), seems to have been unsure as to whether there was in fact any ‘gap’ in the legislation which required filling.

The Supreme Court noted that transfers involving companies were not, prior to the new legislation, entirely beyond the scope of the TOAA code. For example, before the introduction of the new provisions, an individual who transferred assets to a wholly owned UK company and then procured, in connection with the first transfer, the transfer of the assets abroad by the company, would probably have been caught by the associated operations provisions in s 716(1)(b)(ii) and s 719(1). In any event, the new provisions clearly now bring within the scope of the TOAA code transfers by close companies whether or not they form part of a series of transfers comprising associated operations.

The purpose of s 720A as expressed by s 720A(1) is broader than the purpose of s 720. S 720(1) reads as follows:

> *(1) The charge under this section applies for the purpose of preventing the avoiding of liability to **income tax** by*

individuals who are . . . UK resident by means of relevant transfers.

S 720A extends the charge under s 720 to relevant transfers carried out by closely held companies but for the wider purpose of 'preventing the avoiding of a liability to **taxation**' in general. The term 'taxation' is given the same meaning as in s 737(7), namely:

> *"taxation" includes any revenue for whose collection and management the Commissioners for Her Majesty's Revenue and Customs are responsible.*

This change makes it clear that the provisions are <u>not</u> intended to apply only in cases where income tax has been avoided. The taxpayers argued as far as the Court of Appeal[5] in *Fisher* that it was necessary for an amount of income tax to have been avoided before s 720(1) to be engaged. The new provisions clearly frustrate that argument in the context of transfers by companies. The provisions would cover a scenario analogous to *Fisher* in which the transfer of a

[5] The Supreme Court did not consider the argument in light of its comments on relevant transfers.

company’s assets resulted in a reduced betting duty liability (a reduction in a liability to taxation).

In that connection, while the Court of Appeal in *Fisher* ultimately held that there was no need for an income tax liability to have actually been avoided, the actual avoidance of some liability to taxation appears to be a requirement for the application of s 720A. The second limb of the avoidance condition in s 720A(5)(b) (discussed below) is that the individual is aware that one of the direct or indirect consequences is the avoidance of a liability to taxation. This presupposes that there is a real liability to taxation being avoided which the taxpayer must be aware of. It is difficult to see how the avoidance condition could be met (see below) and how s 720A could consequently have any application if there was no actual avoidance of a liability to taxation by which to test the taxpayer’s awareness.

The two conditions engaging the provision

S 720A(2) establishes that the application of the charge under s 720 is contingent on the fulfilment of two conditions. First, an individual must be ‘involved’ in the company (call this the ‘**involvement condition**’). Second, the ‘avoidance condition’ must be met.

<u>The involvement condition</u>

S 720A(2) and s 720A(3) articulate the involvement condition in two steps. First, s 720A(3) refers to a ‘qualifying interest.’ Any individual who is either a participator in a company or has a nominee who is a participator in a company has a qualifying interest in that company as well as in any subsidiary in which the company is a direct or indirect participator.

Second, the concept of a qualifying interest founds a statutory presumption (or, in other words, forms the basis for a deeming provision) in s 720A(4) that an individual with a qualifying interest in a company is ‘involved’ in that company. The presumption may be overturned if ‘the individual satisfies an officer of HMRC that neither the individual nor…the relevant participator [the individual or the individual’s nominee]’ has any direct or indirect involvement in the decision making of the company.

Given the overall purpose of the legislation it is perhaps trite to observe that an individual can only be ‘involved’ in a company for the purposes of s 720A(3) and s 720A(4) if they have a qualifying interest in the company. So, only those deemed or presumed to be involved by s 720A(4) can be treated as involved for the purposes of the legislation. In other words, an individual who is not a participator but who might in an ordinary sense be 'involved' in the decision making of a company (a director who is not a participator, for example) cannot themselves be 'involved' in the company for the purposes of the provisions.

However, anyone who is a participator and so holds a qualifying interest in a company which makes a relevant transfer will be presumed to be involved in the company irrespective of the extent of their participation. The presumption of involvement is rebuttable if an individual with a qualifying interest can satisfy HMRC that they are not involved in the decision making of the company. The legislation expressly refers to 'the decision making of the company' and not the decision making in respect of the transfer. So, it would seem insufficient for the purposes of rebutting the presumption merely to show that the individual was not involved in the decision to effect the transfer itself if they were otherwise generally involved in the decision making of the company at other times.

The legislation provides for both ‘direct’ and ‘indirect’ involvement. ‘Direct’ involvement in the decision making of a company presumably includes participating in the relevant decisions by voting at board meetings. However, it does not necessarily follow that voting at board meetings alone exhausts the limits of direct involvement. It is possible to imagine scenarios – where there are shadow directors who are shareholders, for example – in which the involvement of an individual in the decision making of the company is ‘direct’ in the ordinary sense of the word. The shadow-director, for example, has no authority to take part in the decision-making process but nevertheless directly influences the outcome of that process because the other directors simply act on their instructions.[6]

There are good reasons to suppose that ‘indirect involvement’ is similarly intended to be a concept of broad application. As a matter of ordinary language, the term clearly envisages actions at one or more removes from actual involvement in corporate

[6] Although if this is not correct it is clear that the individuals would be ‘indirectly involved’ or otherwise caught by the anti-avoidance condition in s 720A(7), instead.

decision making. Clearly, that could encapsulate a variety of potential relationships between the individual, the company and its directors. The most obvious example of such a relationship is one whereby the advice or views of the individual are sought by those with the authority to give effect to the transfer.

The conclusion that consultation or advice would constitute ‘indirect involvement’ is justified by the structure of the provisions. All participators are presumed to be involved in a company (see above), but not every category of participator as defined in s 454 CTA 2010 will necessarily be ‘involved’ in the corporate decision making of the company in the sense that they are able to procure that the company will take a specific course of action. Shareholders with no voting rights and loan creditors exemplify participators of this kind. It would be unusual if the legislation defined a ‘qualifying interest’ and established the presumption in favour of involvement by reference to all ‘participators’ if some categories of participator as defined in s 454 CTA 2010 were always intended to fall outside the scope of the involvement condition by reason of having no formal power to procure that the company takes a specific course of action.

This conclusion can perhaps also be inferred from the requirements of the avoidance condition. As is discussed below, the avoidance condition is met in circumstances when an individual (1) does not object to the transfer (2) in circumstances where they ought reasonably to be aware of the transfer and that the consequences of the transfer will include an avoidance of a liability to tax. If one presumes that the avoidance condition is only relevant if the involvement condition has been met (otherwise it is not in point), it follows by implication that anyone 'involved' in the company will be, as a minimum, in a position to meaningfully 'object' to the transfer and would ordinarily be expected to be aware of the company's transactions. An individual whose views or advice are sought on transaction would clearly meet this description.

There is therefore a plausible reading of the legislation under which an individual may be 'indirectly involved' in a company by virtue simply of being consulted by those with the power to procure a transfer by the company. Cases will obviously turn on their facts. HMRC may (and indeed on the wording of s 720A(4), are likely to) accept that a one-off discussion between an individual and a company's directors may not be sufficient for that individual to be taken to be generally involved in the decision making of the company, whereas a pattern of consultation by the directors and the individual in respect of various corporate decisions would likely militate in favour of a different conclusion.

The involvement condition: anti-avoidance

S 720A(7) contains an anti-avoidance rule disregarding any 'arrangements to secure that a person has no direct or indirect involvement in the decision making of a company.' Given that the involvement condition as articulated in s 720A(3) and s 720A(4) is of broad application and provides for a presumption in favour of HMRC, it is not obvious what specific mischief s 720A(7) was intended to address.[7]

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[7] The Explanatory Notes to the Finance No 2 Act 2024 are uninformative. They state that the provision ensures that 'any arrangements are conducted for genuine purposes and not to avoid a liability to taxation.'

Specific examples of cases in which s 720A(7) might apply are hard to imagine. One possibility is that s 720A(7) is intended to apply to scenarios involving ‘blind-eye’ knowledge (where, for example, an individual deliberately absents themselves from corporate decision making to justify a later claim that they were not ‘involved’ and thus escape liability arising from a transfer that they expected or suspected would happen). Alternatively, the provision might catch a device whereby a participator tried formally to limit their involvement in a company solely to the relevant transfer (perhaps by way of shareholders’ agreement or amendment to the articles of association) with the aim of demonstrating to HMRC that they were not generally involved in the decision making of the company within the meaning of s 720A(4).[8] However, the most realistic way to explain s 720A(7) is probably as a general mop-up provision for HMRC to fall back on in extraordinary cases.

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[8] Although one might query whether in this example being involved in negotiations to amend the articles or enter the shareholders agreement wouldn’t itself be involvement in the general decision making of the company.

The avoidance condition

S 720A(5) creates a two-stage test which must be satisfied for the avoidance condition to be met overall. First, the individual or nominee must not have objected to the transfer. Second, they must reasonably have been aware of the transfer and that, as a matter of fact, one of the direct or indirect consequences of the transfer is the avoidance of a liability to taxation.

An important question is what it means in the first limb of the condition to 'object' to a transfer, bearing in mind the different degrees to which any individual potentially subject to the charge could be 'involved.' Presumably an individual participator with voting rights will be expected by HMRC both to express opposition to and to vote against any transfer. The position is less clear for those only 'indirectly involved.' However, the presumptive starting point must at the very least be that anyone consulted who happens only to be indirectly involved must unambiguously indicate their disagreement to the proposed transfer (and record it) to avoid inadvertently satisfying the first limb of the avoidance condition.[9]

The second limb of the test applies if the individual 'ought reasonably to have been aware' of the transfer and that one of the 'direct or indirect consequences of the transfer is the avoidance of a liability to taxation.'

It is relatively easy to understand how a taxpayer might be expected to go about demonstrating that it was reasonable for them not to have been aware that the avoidance of taxation was a direct consequence of the transfer. Presumably in all but the simplest transfers a failure to obtain professional advice will cause the taxpayer significant difficulty in persuading HMRC that it was reasonable for them not to be aware of the tax consequences. In the simple cases, the existence of a direct consequence of tax avoidance might be so obvious that it would be implausible for the individual to deny they were aware of it.

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[9] Although note that, for the reasons that follow below, objecting solely on the basis of preventing the avoidance condition from being met may not be effective.

However, the legislation provides no clues as to how much foresight an individual will be expected to have as to the avoidance of a liability to taxation being one of the <u>indirect consequences</u> of a transfer. The answer surely depends on HMRC's view of how remote any indirect consequences must be from the transfer before they do not require consideration. Given the complexity of the UK tax code and the wide meaning given to 'taxation', it will surely always be possible to reach a view that a transfer has given rise <u>indirectly</u> to the avoidance of taxation if one looks hard enough. Suffice it to say that the legislation clearly envisages that individuals will have thoroughly interrogated the potential consequences of the transaction if they are to satisfy HMRC as to the reasonableness of their conclusions.

<u>The avoidance condition: anti-avoidance</u>

S 720A(8) contains widely drafted anti-avoidance provisions targeted at the avoidance condition. The subsection disregards any 'arrangements' with the main purpose (or one of the main purposes) of securing that the avoidance condition is not met. 'Arrangements' includes, *inter alia*, an 'understanding.' Objecting to a transfer on the understanding that this would prevent the first limb of the avoidance condition being met would therefore seem to have no effect in disapplying the condition, even in circumstances where the individual objecting was powerless to prevent the transfer taking place.

Consider one of three participator-directors with equal shareholdings in a close company who casts a minority vote against the decision of the other two to make a relevant transfer. The shareholder's reason for doing so is to avoid being made subject to the TOAA code by virtue of the transfer. The shareholder votes against the transfer on the sole understanding that, by objecting, the avoidance condition will not be met. It therefore follows that the shareholder had an understanding in objecting or voting against the transfer the main purpose of which was to prevent the avoidance condition being met. S 720(8) is consequently engaged and the shareholder is nevertheless caught by the TOAA code.[10]

[10] This problem might be especially pronounced in cases where some of the participators in a close company are UK residents potentially subject to the TOAA code and others are non-UK residents unconcerned by the same provisions.

Conclusion

The new provisions are widely drawn. Unfortunately, various important terms are ambiguous. What are the limits to 'indirect involvement'? Which 'indirect' tax consequences of a transfer ought an individual be reasonably aware of? In the absence of further legislation or clarificatory amendments, taxpayers will need guidance from HMRC. However, guidance has well-known limitations, not least the fact that a taxpayer may not be entitled to rely on it and that it may not cover complex or unusual circumstances.

It appears that those drafting the provisions considered this ambiguity to be an acceptable trade-off for the sake of ensuring that the provisions were of the broadest possible application. That is an approach that taxpayers are now begrudgingly familiar with when it comes to anti-avoidance legislation, but it is particularly unsatisfactory so as far as the TOAA code is concerned. In *Fisher*, the Supreme Court forcefully rejected HMRC's submission that ambiguity in the TOAA code should be preserved simply to deter taxpayers from engaging in transactions which might engage it. That critique does not appear to have been acknowledged or applied in the course of drafting s 720A and s 727A.

IS A FAILURE TO EXCLUDE THE SETTLOR ALWAYS A GIFT WITH RESERVATION OF BENEFIT?

David Tipping

Introduction

When settling a new trust, it is common to include a class of beneficiaries and then grant the trustees a power to add further individuals as beneficiaries to the trust. Such a power can be in relation to specific persons, in which case it is a specific power, or can permit anyone at all to be added (a general power). It can also be provided that the trustees can add anyone at all, except for certain named persons, which is an intermediate power.

It is generally prudent to exclude the settlor from all benefit unless it is specifically intended to do so. Doing so can prevent triggering a number of different anti-avoidance provisions, such as the Settlements Code in section 624 Income Tax (Trading and Other Income) Act 2005, or the Transfer of Assets Abroad legislation (in relation to overseas trusts). This would include excluding the settlor from being added to the trust as a beneficiary at a future date.

Suppose that a settlor is not a beneficiary of a discretionary trust, but is also not excluded from being added as a beneficiary at a later date under a intermediary or general power. As noted above, this is likely to have various tax implications. This article examines the consequences for the purposes of inheritance tax.

In particular, it asks whether the failure to exclude a settlor from a power to be added as a beneficiary amounts to a gift with reservation of benefit ("**GROB**")?

Section 102 FA 1986

The key provision regarding GROBs is section 102 FA 1986. It is likely that readers will be familiar with the legislation, but it is a densely drafted section and useful to break down. For that reason, section 102 has been quoted below, followed by a brief explanation of the relevant subsections.

Section 102 provides that:

"(1) Subject to subsections (5) and (6) below,[1] this section applies where, on or after 18th March 1986, an individual disposes of any property by way of gift and either—

(a) possession and enjoyment of the property is not bona fide assumed by the donee at or before the beginning of the relevant period; or

(b) at any time in the relevant period the property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise;

and in this section "the relevant period" means a period ending on the date of the donor's death and beginning seven years before that date or, if it is later, on the date of the gift.

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[1]Subsections (5) and (6) include certain exceptions and exemptions from the general rule. They are not relevant to the present discussion and therefore have been omitted.

(2) If and so long as—

(a) possession and enjoyment of any property is not bona fide assumed as mentioned in subsection (1)(a) above, or

(b) any property is not enjoyed as mentioned in subsection (1)(b) above,

the property is referred to (in relation to the gift and the donor) as property subject to a reservation.

(3) If, immediately before the death of the donor, there is any property which, in relation to him, is property subject to a reservation then, to the extent that the property would not, apart from this section, form part of the donor's estate immediately before his death, that property shall be treated for the purposes of the 1984 Act as property to which he was beneficially entitled immediately before his death.

> (4) If, at a time before the end of the relevant period, any property ceases to be property subject to a reservation, the donor shall be treated for the purposes of the 1984 Act as having at that time made a disposition of the property by a disposition which is a potentially exempt transfer.”

Subsection (1) is the gateway into section 102. It is important to note that the opening words of subsection (1) impose two preliminary conditions.

First, only individuals can make a GROB. Therefore, the rules do not apply to gifts or other disposals by companies, even if it is a close company that would give rise to an immediate charge on participators under section 94 IHTA 1984. HMRC even publicly accept that this is so. In the HMRC Manuals at IHTM14312, it acknowledges that:

> “The donor has to be an individual. Gifts made by persons who are not individuals (such as companies) are not within the scope of the gift with reservation (GWR) provisions.”

Secondly, the property must be disposed of by way of gift. “Gift”, in this context, carries its ordinary meaning as a matter of law. HMRC suggests that an interest-free loan can constitute a “gift”, but this is doubtful (see Chamberlain et al. *Trust Taxation and Private Client Tax Planning* at 31.22A). A loan is, by definition, not a gift because the original property must be repaid.

Paragraphs (a) and (b) then introduce the substantive conditions. These broadly define the reservations that turn a gift into a GROB. It should be noted that paragraph (b) contains two distinct, albeit closely related, limbs: the property must be enjoyed to the exclusion (or virtual exclusion) of the donor ***and*** to the exclusion of any benefit to the donor.

Where either subsection (1)(a) or (1)(b) are satisfied, subsection (2) is engaged. It provides that the property in question will be property subject to a reservation for so long as the relevant paragraph of subsection (1) is met. Because this definition is continuous through time, property can become a GROB long after the initial gift. For example, suppose that a father gives a residential property to his daughter. At some point in the future, due to a change in circumstances, the daughter invites her father to live with her in his former house.[2] Irrespective of the amount of time that passes, the house will become property subject to a reservation when the father moves in.

Subsection (3) then sets out the consequences of having property subject to a reservation. If, at the time of the donor's death, there is property subject to a reservation, that property will be treated as part of his estate immediately before his death. In other words, if there is property subject to a reservation, the donor will be liable to pay inheritance tax on it when he dies.

Subsection (4) makes clear that, if the property stops being subject to a reservation, it is a transfer of value of the property, subject to all the normal rules of inheritance tax.

In response to the introductory question of this article, a settlement into a trust, subject to an

[2] Schedule 20 to FA 1986 contains an exception to section 102 FA 1986 in these circumstances if, among other conditions, the donor has become unable to maintain himself through old age, infirmity or otherwise.

intermediary power to add the settlor as a beneficiary of the trust, will be a GROB if section 102(1) is satisfied. Unfortunately, this is not as clear cut as one would like.

<u>Section 102(1)(a)</u>

In this discussion, subsection (1)(b) is the more relevant condition. However, it is always necessary to check that (1)(a) is not engaged either.

In the context of a trust, the donee for the purposes of subsection (1)(a) is the trustees. It is even possible for the settlor to be the trustee of the settlement without creating a reservation under subsection (1)(a). This is apparent from the old Privy Council's decision in *Oakes v Commissioner of Stamp Duty of New South Wales* [1954] AC 57, in which the Privy Council was considering Australian provisions that were effectively identical to section 102. Lord Reid held at 72:

> "If property is held in trust for the donee, then the trustee's possession is the donee's possession for this purpose, and it matters not that the trustee is the donor himself."

However, this depends on his possession and enjoyment of the property being bona fide *in his capacity as trustee*. For example, in *Personal Representatives of Lyon v Revenue and Customs Commissioners* [2007] STC (SCD) 675, the settlor had also made himself trustee. The Special Commissioners found that he had done so in order to retain significant control over the distribution of trust assets. In particular, he ensured that he continued to benefit from them. Therefore, there was a GROB on the basis of subsection (1)(a).

The Special Commissioners also found that, irrespective of their conclusions on subsection (1)(a), there was also a GROB on the basis of subsection (1)(b), to which we now turn.

Section 102(1)(b) – Published Views

There is no clear consensus about whether the potential to add a settlor to the list of beneficiaries of a trust is enough to render the entire settlement a GROB. It is certainly clear that HMRC consider that a settlor must be explicitly excluded from benefiting from a trust to escape section 102. In their manual at IHTM14393, HMRC make the following statement:

> “**Example 1**
>
> Anthony transfers assets into a discretionary settlement under which he is not included in the class of beneficiaries. There is however power to the trustees to add beneficiaries including Anthony to the class at some future date. That Anthony can be considered as a potential beneficiary is sufficient to say that the trust fund is not enjoyed to the entire or virtually to the entire exclusion of benefit to him under the settlement and the gift will be a GWR (*CIR v Eversden* [2003] STC 822). Only if the trust irrevocably excludes Anthony from being a beneficiary under the trust will a GWR not arise.”

We will return to the *Eversden* case to examine whether this is really authority for the proposition which HMRC contend.

Leading textbooks are surprisingly divided on the difficult question.

McCutcheon’s on Inheritance Tax notes HMRC’s view and states at 7-79 that:

> "A reservation of benefit potentially also arises where a settlor is not included as a beneficiary at the outset, but the settlement includes a power for the trustees to add him to the class of beneficiaries at some future date."

In stark contrast, *Dymond's Capital Taxes* adopts a much stronger position which contradicts HMRC's view. At 5A.504, the editors write:

> "If the settlor was not a named beneficiary but the trustees had a wide power to add additional beneficiaries which could be exercised to add him the position is not wholly clear cut. The view of the editors is that no reservation of benefit arises until such time as the settlor is added provided that as a matter of fact the trust fund is enjoyed to his entire exclusion, and he receives no benefit. Therefore neither limb in s.102(1)(b) is satisfied unless and until he is added or until he receives benefits or enjoys the property."

Similarly, the authors of *Trust Taxation and Private Client Tax Planning* state at 44.40 that:

> "The position is different if the settlor is not a member of the discretionary class but the trustees have a power to add beneficiaries which they could exercise to add the settlor. He is, of course, only capable of benefiting if this power is exercised and the author would therefore argue that unless and until that happens he is not capable of benefiting so that there is no ROB provided that as a matter of fact the trust fund is enjoyed to his entire exclusion, and he receives no actual benefit."

Notably, both *Dymond's* and *Trust Taxation* state that this position is supported by the comments of Lightman J in *Eversden v Commissioners of Inland Revenue* [2002] STC 1109.

In support of the opposite position, HMRC cite the Court of Appeal's decision in the same case. However, the Court of Appeal only had to decide whether section 102(5) was engaged in relation to the settlement, which is not relevant to this point. Lightman J's judgment remains the leading authority on section 102(1)(b) because that element was not appealed. Therefore, it is necessary to examine the decision in detail.

<u>Case Law</u>

The facts in *Eversden* were as follows. A settlor appointed herself and two others as trustees of property, to be held on trust for her husband for life. However, this was subject to a special power of appointment, permitting the trustees to pay out sums to a discreet class of beneficiaries, which included the settlor herself. After her husband's death, the settlor was the sole occupier of the residential property in question.

Lightman J, on appeal to the High Court, held that the section 102(1)(b) was satisfied and the settlement amounted to a GROB for two reasons. First, the second limb of section 102(1)(b) was satisfied in relation to the residential property, because the settlor benefitted from the occupation of the property. Secondly, in relation to the entirety of the property held on trust, the first limb of section 102(1)(b) was satisfied because of her status as a discretionary beneficiary.

This is clearly a very different set of facts from HMRC's example involving Anthony above. Unlike the settlor in *Eversden*, Anthony is not named as a beneficiary. Therefore, it is necessary to examine Lightman J's reasoning in greater detail.

He began by examining the rights of a beneficiary. He quoted Lord Wilberforce's classic description of the nature of a beneficiary's rights from *Gartside v IRC* [1968] AC 553:

> "No doubt in a certain sense a beneficiary under a discretionary trust has an "interest": the nature of it may, sufficiently for the purpose be spelt out by saying that he has a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a court of equity. Certainly that is so, and when it is said that he has a right to have the trustees exercise their discretion "fairly" or "reasonably" or "properly" that indicates clearly enough that some objective consideration (not stated explicitly in declaring the discretionary trust, but latent in it) must be applied by the trustees and that the right is more than a mere spes."

Lightman J then held as follows:

> "[16] The commissioner in para 79 of the decision held that the settlor's entitlement to be considered as a potential recipient of benefit by the trustees precluded a finding that the trust fund was enjoyed to the entire or virtually the entire exclusion of benefit to her under the settlement.
>
> [17] I entirely agree. The insertion of the provision enabling benefit to be conferred on her creates the potential for the conferment of substantial benefit on her and the consequent diversion of benefit from others. The provision in her favour is not consistent with her entire exclusion or her virtual entire exclusion from benefit. It cannot be entirely discounted or virtually entirely discounted by evaluation of the probabilities or otherwise that occasion will arise for conferring benefits on her.
>
> [...]
>
> [19] If s 102 were so construed that the interest of any settlor under a

> discretionary trust created by him does not constitute a reservation of benefit, there would be opened up a means of totally defeating the plain object of s 102. The alternative construction is both available and preferable."

This passage reveals two complimentary reasons. First, the nature of a discretionary beneficiary's interest is inconsistent with the legislation's notion of exclusion. Secondly, there is a purposive argument that permitting a settlor of a trust to benefit from the assets would drive a coach and horses through section 102.

In the writer's view, neither of these reasons justify extending the scope of section 102 to a settlor who is not a beneficiary but has not been excluded from an intermediary power to add beneficiaries.

Nature of a Power to Add Beneficiaries

A discretionary trust and a broad power are undoubtedly similar. Indeed, the Privy Council in *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26 observed that "*The differences in this context between trusts and powers are… a good deal less significant than the similarities*." Those similarities include the equitable remedies available to both beneficiaries and objects of a power. Both can apply to the court to remove the trustees (*In re Manisty's Settlement* [1974] Ch 17) and both can seek disclosure of trust documents (*Schmidt v Rosewood Trust* above).

Nevertheless, there is an important, albeit fine, distinction between

Firs. In a trust, the trustees must exercise their discretion. However, in regard to a power, the trustees merely need to consider whether or not to exercise it. There is no obligation on the trustees to ever add anyone as a beneficiary. Therefore, to the extent that a discretionary beneficiary can be said to have a proprietary interest in the assets of a trust, the object of an intermediary power cannot even be said to have that.

Judicial support for this distinction can be found in Jersey. In *Re Exeter Settlement* [2010] JLR 169, the trustees of a settlement argued that there was no meaningful difference between a discretionary trust for a small number of beneficiaries, subject to a power add anyone as a beneficiary, and a discretionary trust for anyone's benefit. The Royal

Court disagreed and is worth quoting at length. It held that:

> "[29] In our judgment, one must return to first principles. A beneficiary of a discretionary trust is a person in whose favour a discretion to distribute income or capital of a trust may be exercised. Trustees may only exercise their power to distribute income or capital in favour of a person who is a beneficiary. It is the beneficiaries who are the objects of the discretionary trust. They must be sufficiently certain to satisfy the requirement as to certainty of objects.
>
> [30] **A power to add beneficiaries is something completely different**. It means what it says. A person who is a possible object of a power to add beneficiaries is not in fact a beneficiary unless or until the power is exercised in his favour and he is added as a beneficiary. Until that moment, the trustees may not apply income or capital for his benefit and he does not have any of

the rights attached to being a beneficiary of the trust. The sole right that he has is as a possible object of the power to add beneficiaries.

[31] We therefore respectfully disagree with the court in Rawcliffe when it used the expression “sub-class of beneficiary,” thereby implying that those who were merely objects of a power to add beneficiaries were themselves some sort of beneficiary. We understand the point which Mr. MacRae makes to the effect that there may not be a great practical difference between, on the one hand, having a small class of beneficiaries with a power to add anyone in the world as a beneficiary and, on the other hand, a discretionary power to distribute in favour of anyone in the world. In each case, the trustees can ultimately arrange to distribute in favour of anyone in the world. But **there is an important difference in principle**. In the former case, **they will have to exercise a power to add a particular person as**

> **a beneficiary and only thereafter will they be entitled to exercise a power to distribute income or capital to that beneficiary**." (**emphases added**)

This decision touches on an important point of principle. A settlor who is an object of an intermediary power cannot benefit from the trust until that power is exercised. It is, to that extent, different from the interest of a discretionary beneficiary described by Lightman J in *Eversden*. The object of an intermediary power does not even have the potential for significant benefit. He is one step further removed: he has nothing more than the mere possibility of being added to a list of people who may potentially receive benefits from the trust.

Therefore, on an ordinary reading of the language of section 102(1)(b), the assets of the trust are enjoyed virtually to the entire exclusion of the settlor, even if the settlor could be added to the list of beneficiaries at some later date. The settlor is not permitted to benefit under the terms of the trust until this power is actually exercised by the trustees. .

Purpose of Section 102

Lightman J supported his analysis by reference to the purpose of section 102. That purpose is evident from the words and effect of the legislation: it is to prevent donors from giving away the value of their estate, thereby minimising their liability to inheritance tax, while retaining the use and benefit of that property.

Intuitively, one might be concerned that even the mere possibility of being added as a beneficiary is contrary to the purpose of these provisions. However, taking this reasoning to its logical conclusion would risk treating every gift as being subject to a reservation. For example, a simple gift from parent to child is not subject to any restriction on what it can and can't be used for. Once the gift is the property of the donee, there is nothing stopping him from gifting it back to his parent at some time in the future. This follows simply from the donee's freedom to dispose of his property as he chooses. That mere possibility, however, does not turn the initial gift into a GROB. The mere fact that such a possibility exists does not contravene the purpose of section 102.

Instead, there must be a dividing line between mere possibilities that do not engage section 102 and circumstances which do amount to GROBs. In the writer's view, that dividing line is the difference between being the object of an intermediary power and being the beneficiary of a discretionary trust. In the former circumstances, the settlor is not in materially different circumstances as if they had made an absolute gift of the property. If the settlor is within the class of beneficiaries, then it is specifically envisaged that the settlor could benefit from the trust, or is at least entitled to be considered.

This distinction also provides a boundary which can be effectively policed by HMRC. While the settlor is not a beneficiary, the trust assets do not form part of the settlor's estate (subject to being a potentially exempt transfer and the settlor surviving 7 years). Once the decision is made by the trustees to exercise their intermediary power and add the settlor to the class of beneficiaries (or if the settlor was to receive any benefit from the trust), the assets of the trust would become a GROB.

Comparison with Income Tax and CGT

Although the point was not raised in *Eversden*, it may be argued that this interpretation of section 102 is inconsistent with provisions in respect to income tax and capital gains tax.

For example, for income tax purposes, income arising to a settlement will be treated as the income of the settlor if the settlor has "an interest" in the property (section 624(1) Income Tax (Trading and Other Income) Act 2005). An "interest" for these purposes is defined in section 625(1) ITTOIA 2005 as:

> "… any circumstances in which the property or any related property–
>
> (a) is payable to the settlor or the settlor's spouse or civil partner,
>
> (b) is applicable for the benefit of the settlor or the settlor's spouse or civil partner, or
>
> (c) will, or may, become so payable or applicable."

This language, and particularly subsection (c), will include any living settlor who could potentially be added as a beneficiary of a trust.

It could be argued that the rules should be consistent between different taxes and that, if a settlor is caught for the purposes of income tax, then the same trust should amount to a GROB for the purposes of inheritance tax.

There are several arguments that can be made in reply.

First, these provisions are worded very differently. It is therefore not surprising that these result in different outcomes.

Secondly, it could be argued that the different wording is indicative that Parliament intended the two provisions to reach different outcomes. If it was already thought that the wording of section 102 would catch the potential to benefit from the trust in the future, one might ask why very different language was adopted in ITTOIA 2005?

Thirdly, and most importantly, income tax and inheritance tax are different regimes, and the distinct outcomes within the legislation are consistent with those differences.

Income tax, for example, is levied annually on the basis of income arising in a particular year. The purpose of section 625 is to ensure that a settlor cannot escape income tax by having income paid into a trust in one year and then receiving it at a later date when the tax charge has passed.

Inheritance is, on the other hand, completely different. It is quintessentially a one-off tax levied at the time of death. There are numerous exceptions to this, such as chargeable lifetime transfers into trusts and the 10-yearly charge levied on relevant property. However, these are the exceptions which prove the rule. Generally, inheritance tax only needs to look backwards and consider whether the actions of the deceased bring property within their estate. Section 102 FA 1986, in particular, is not concerned with some unspecified future date because, by definition, it is only relevant once the donor has died. At that point, it goes without saying that there is no potential for the settlor to be added in to the trust as a beneficiary!

There is no rationale for section 102 to include a settlor who may be included in the list of beneficiaries at some point in the future, because of the backward-looking nature of the tax. Either the settlor was within the class of beneficiaries at the time of his death, or he was not. His status as an object of an intermediary power ought not to be relevant.

Conclusion

In the writer's opinion, if there is any *de minimis* interest which can be enjoyed without triggering the GROB provisions in section 102, it is being the object of a power to add beneficiaries. Such an interest, if it can even be so described, is the smallest possible equity and does not amount to any form of entitlement to the assets of the trust.

Having analysed Lightman J's reasoning in *Eversden*, it would be consistent with that decision (and a number of leading textbooks) to conclude that a settlor who is not a beneficiary, but is the object of a power to be added as a beneficiary, has not made a GROB of the trust assets.

Nevertheless, readers should proceed with caution. Given this conclusion is contrary to HMRC's published views, one can expect that they would challenge this in the courts if necessary. Therefore, excluding the settlor from any powers to add beneficiaries remains the most prudent advice in the majority of circumstances.