



FIELD COURT TAX CHAMBERS

FCTC DIGEST

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EDITORIAL

Patrick Soares

Welcome to the Digest.

The first article by the editor deals with some of the teething problems experienced by practitioners when advising on the **4-year tax-free holiday**, which is available to new UK residents who have not been resident in the UK for the prior 10 years. This relief is valuable for taxpayers who come to the UK to give them time to sort out their overseas tax problems in a UK tax-free environment on their foreign income and gains (their FIG). They must note, however, that not all foreign share sales are tax-free, and they must double-check and be able to prove they have not been UK resident in any of the prior 10 years.

The second article, also by the editor, examines the current state of the **source doctrine** and recent cases. It is the **DNA of the income tax system**. It is very much alive and kicking but there are cases where an income tax charge can arise even if there is no source.

The third article is by **Patrick Way KC**. He describes how the **Ramsay principle** has developed over time. It is a rule of statutory interpretation no more no less. In its present state, it requires the legislation to be read on a purposive basis, requiring the courts to identify the intention of the relevant statute and then to construe that legislation in accordance with the identified intention. A realist view of the facts is also required.

The fourth article is by **Peter Vaines**. It deals with the Court of Appeal decision of **AD Bly Groundworks and Civil Engineering Ltd v HMRC** [2025] EWCA Civ 1443, which was concerned with whether a provision for future pension payments was deductible for corporation tax. It was held that the mere provision was not deductible but there are some puzzling aspects to the case which Peter deals with.

In the fifth article, **Peter Vaines** updates his article on **pensions and IHT** which he did in the last edition of the *Digest*. The changes in the Finance Act 2026 deal differently with those who die after their 75th birthday from those who die before. He concludes: *anybody over the age of 75 who has not*

yet drawn their pension is likely to regard this as a tad unsatisfactory.

In the sixth article, **Dilpreet K Dhanoa** deals with the recent Upper Tribunal decision in **Illuminate Skin Clinics Limited v HMRC** [2025] UKUT 341 (TCC). It is important in that it identifies the test to be applied where a treatment has both a cosmetic purpose and a possible therapeutic purpose, and it explains what evidence may be needed to bring such a supply within the VAT exemption for medical care.

The seventh article is by **David Tipping**. Legal privilege is a valuable right of the client (not the lawyer), although HMRC often ask taxpayers to release privileged opinions voluntarily if they have nothing to hide. Note if an opinion is so voluntarily produced the taxpayer may also need to produce the instructions unless the position is agreed beforehand. If the opinion is in the public domain, privilege may be lost in any event. David **gives a warning on how privilege may be lost** if, for example, the advice is uploaded to a chatbot (such as ChatGPT). In the immigration and asylum chamber of the Upper Tribunal in **UK v Secretary of State**

for the Home Department [1926] the Tribunal stated:

“We also observe that to put client letters and decision letters from the Home Office into an open source AI tool, such as ChatGPT, is to place this information on the internet in the public domain, and thus to breach client confidentiality and waive legal privilege...

The final article is by **Lachlan Molesworth**. It looks at information exchange between states. Practitioners are often asked what information will state A provide to state B so an article on this subject is always a welcome read. This important paper explores the efforts and limitations associated with cross-border **information exchanges** as instruments aimed at curbing tax evasion and avoidance. It examines information exchange in promoting transparency and deterring evasion and avoidance activities. It also explores obstacles hindering the effectiveness of such initiatives, including legal, technological, and political aspects.

Patrick C Soares

THE FOUR YEAR TAX-FREE HOLIDAY ("THE 4 YEAR FIG") – TEETHING PROBLEMS

Patrick C Soares

Introduction

From 6 April 2025, all UK residents have been taxed on the arising basis of assessment, although the remittance basis remains for pre-6 April 2025 income and gains in appropriate cases.

Tax advisers must continue to be experts in both regimes.

A new regime for foreign income and gains (FIG) is available to individuals for their first four years of UK tax residence after a period of 10-years non-residence.

Individuals who make a claim to use the new 4-year FIG regime will not pay tax on FIG arising in those four years.

Example

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 with regards to his overseas income and gains.

Example

Mr Y who has visited the UK off and on over the last 15 years decides to make use of the 4-year FIG regime and (at the same time) break his tax residence with Ruritania. He can sort out his tax affairs in the 4 year period. He must check that his visits to the UK over the last 10 years have not resulted in his being resident in one of the years (note this may involve the taxpayer looking at his activities over 12 years to determine his residence for the last 10 years).

THIS IS A GIFT FOR THOSE WHO WANT TO RESOLVE THEIR TAX PROBLEMS IN RURITANIA WHILE BEING RESIDENT IN THE UK AND BENEFITING FROM THE FIG REGIME AND THE TERMS OF THE TAX TREATY BETWEEN THE UK AND RURITANIA.

IT IS ALSO A GIFT FOR THOSE WHO WANT TO DISPOSE OF THEIR FOREIGN COMPANY DURING THE 4-YEAR PERIOD

Legislation

The legislation is in FA 2025 s37-39 and ITTOIA 2005 s845A et seq and ITEPA 2003 s41M et seq and TCGA 1992 schedule D1.

Eligibility

The 4-year FIG regime will only be available for:

1. individuals
2. who are UK resident (it is necessary to refer to the statutory residence code (SRT))
3. who are within their first four years of UK tax residence,
4. following a period of at least ten consecutive years of non-UK residence.

An individual cannot qualify if they have been UK resident under the SRT in any of the 10-years prior to arrival. Treaty residence elsewhere under a Double Taxation Agreement (DTA) tie-breaker will not be relevant for the purpose of determining eligibility. The DTA would not enable an individual to be treated

as non-UK resident for the purposes of qualifying for the 4-year FIG regime.

Foreign income and foreign gains

An individual can make a claim with respect to the 4-year FIG regime for either foreign income or foreign gains, or both. The claims are separate; if an individual makes a claim for one they do not need to make a claim for the other.

The claim for the 4-year FIG regime applies on a source-by-source basis. It is not necessary to claim relief on all sources of foreign income and foreign gains. As such the taxpayer can choose what foreign income and which foreign gains on which to claim relief.

Settlement Income – when is the income foreign

In the case of a foreign discretionary settlement payments of income will have a foreign source in the normal case.

Where a beneficiary who meets the criteria for the 4-year FIG regime has a life interest in a settlement,

whether or not the settlement is UK resident, and is chargeable on their share of trust income as it arises, it will be possible to make a claim for the 4-year FIG regime in respect of any foreign income in which they have an interest.

EXAMPLE - LIFE INTEREST SETTLEMENT

Mr X has a life interest in a UK settlement which holds UK shares: that is not FIG income. If the shares were foreign that would be FIG income. The same results would follow if the settlement was a non-UK settlement. The settlement interest itself (the life interest) does not cause a new source to arise (*Baker v Archer-Shee* [1927] AC 844): the source is the shares. The position is different for a discretionary settlement: the trust itself can create a source of income (*Drummond v Collins* 6 TC 525).

Relying on a double tax treaty – Certificate of Residency

Problems can arise if a taxpayer comes to the UK and needs to convince a foreign jurisdiction that s/he is resident in the UK for treaty purposes as soon as possible.

The taxpayer will want to obtain a Certificate of Residency (CoR) from HMRC. If s/he has spent 183 days or more in the UK there will be no problem. If s/he spends less than 183 days in the UK the guidance states:

if you've spent less than 183 days in the UK during the tax year you need the CoR and why you believe you're resident under the Statutory Residence Test (SRT)

The taxpayer in this case must ensure s/he has sufficient ties in the UK to make him or her resident – work ties, accommodations ties etc.

The income must be qualifying foreign income (ITTOIA 2003 s845H)

Not all foreign income qualifies for the 4-year FIG relief.

Practitioners must check the list in s845H and also s845I.

CIOT has complained that Insurance Products are not on the list in s845H. In their submissions of 23 December 2024 CIOT stated:

12. It is common for individuals in some jurisdictions to own life assurance policies which are set up in a standard way for the overseas jurisdiction, but which fall foul of the UK's personal portfolio bond regime, and so these rules are a bear-trap for the unwary. This is especially true of France, though the same issue can arise with insurance policies from other jurisdictions. CIOT therefore considers that all offshore bonds, and including personal portfolio bond gains, should be excluded from UK taxation in the four-year period of FIG exemption especially in relation to policies owned before arrival in the UK.

13. However, the proposed ITTOIA 2005 s 845F lists what items constitute FIG for the purposes of the relief. It omits life assurance products, most notably

offshore investment bonds and personal portfolio bonds. These are important investment vehicles for Europeans in particular and have tax favoured treatment there. There is no need to link the new exemptions to the current remittance regime. The purpose of this regime is to be internationally competitive and give people time to sort themselves out after arrival in the UK. The current exclusion of bonds from the remittance basis under the existing system was always an oddity. Extending this now to exempt FIG will be a trap for the unrepresented. The objective should be to remove deficiencies in the current regime not preserve them.

Performance income is excluded from the list (s845J).

Performance income is any income chargeable to income tax (however that charge arises) that results, directly or indirectly, from the performance of a

relevant activity by a performer (whether performed in the United Kingdom or not).

“Performer” means any individual who gives performances of entertainment or sport.

“Performances of entertainment or sport” includes any activity of a physical kind performed by an individual (alone or with others) which is or may be made available to the public or any section of the public, whether for payment or not.

The following are “relevant activities”—

- (a) the giving of a performance of entertainment or sport;
- (b) the participation of the performer in any sound or video recording;
- (c) any activity in connection with a commercial occasion or event (including the appearance of the performer in connection with the occasion or event).

Warning on performance income

This definition is wide enough to cover income which

directly or indirectly arises to a writer who is paid whenever his works are performed in appropriate cases.

Foreign capital gains (TCGA 1992 sched D1)

The relief is available on the disposal of a qualifying foreign asset e.g. on the disposal of shares in a foreign company (TCGA 1992 Sch D1 para 6).

It may be attractive for taxpayers to come to the UK for the four years and dispose of their foreign shares free of UK tax.

TRAP

A trap to watch out for is some capital share disposals of foreign shares give rise to income tax charges which may not be on the income tax exemption list e.g. disposals within ITA 2007 s773 (sales of occupational income).

Conclusions

The FIG exemption regime is not comprehensive – it omits certain types of foreign income and gains.

The FIG four-year exemption will no doubt prove

useful for those who might now decide to come here for a short time to sell their company tax-free and for those who must come here anyway, e.g. for work purposes.

However, if the regime is intended as a positive incentive to encourage wealthy people to move to the UK and settle here on a longer-term basis, it is unlikely to do the trick: 4 years is too short a period for people to take root.

THE SOURCE DOCTRINE AND INCOME TAX – SOME SURPRISES

Patrick C Soares

INTRODUCTION

The *general rule* is there can be no income tax charge unless the income arises from a source:

“no source, no income tax.”

Income tax is traditionally a source-based annual tax, liability depending upon the existence of a source of income falling under one of the old Schedules during the year of assessment: see *Brown v. The National Provident Institution* 8 TC 57, where Viscount Haldane at 84 stated:

“The expression Income Tax, as used by the Legislature, was a generic description of the tax which was levied under all the Schedules alike and it was not meant to be anything but a tax on income. There was imposed under the Schedules no collection of taxes distinct from, each

other, but simply one tax with standards for assessment which varied according to the sources from which the taxable income was derived.”

Although the schedular system of income taxation has been abolished, following the works of the Tax Law Rewrite, ITTOIA and ITA (the two big income tax statutes) still bear its unmistakable hallmarks.

The exact source can be important to determine:

deductible expenses and

the location of the source: a foreign source is generally tax-free in the hands of a non-resident.

Thus, rent can be charged to income tax as the profits of a property business (ITTOIA 2005 s268). The property business is the source.

If there is a discretionary trust and it makes payments, the trust is the source maker (*Drummond v Collins* 6 TC 525). If there is a trust with an interest in possession, the underlying assets are the source (*Baker v Archer-Shee* 11 TC 749).

A trade is a source (ITTOIA 2005 s5) and it may be a vigorous exercise to determine whether one exists or not. The following factors may need to be considered when determining whether a trade in land exists.

	Cases	Acts or omissions	Indicators for and against	Weighting
(1)	<i>Page v Pogson</i> 35 TC 545	Repetition	If the taxpayer has carried out similar trading transactions before, it is more likely to be a trader	4
(2)	<i>Harvey v Caulcott</i> 33 TC 159	Involvement	If the taxpayer is involved in land transactions generally, e.g., as an estate agent, this points to trading	3
(3)	<i>Taylor v Good</i> [1974] STC 148	Motivation	An intention at acquisition to turn the land (as opposed to an intention	20

			to hold it long term) at a profit is a strong indication of trading	
(4)	<i>Iswera v CC of IR</i> [1965] 1 WLR 6634	Enjoyment	No personal enjoyment, e.g., no personal occupation of a house or flat, may indicate trading	3
(5)	<i>Cooke v Haddock</i> 39 TC 64	Income	If the land is not income producing, this indicates trading	5
(6)	<i>McCellan d v TC of C of A</i> (1971) 1 All ER 969	Gift/ Inheritance	Land acquired by gift or by inheritance indicates non-trading	3
(7)	<i>Turner v Last</i> 42 TC 517	Time	Land held for a short time – this indicates trading	5
(8)	<i>Johnson v Health</i> [1970] 3 All ER 915	Retention	If the taxpayer would not find it difficult to	7

			hold the land long term, this strongly indicates non-trading	
(9)	<i>Iswera v CC of IR</i> [1965] 1 WLR 663	Surplus	If taxpayer has acquired land surplus to its own occupational requirements this may indicate trading	3
(10)	<i>IRC v Livingston</i> 11 TC 538	Work	If the taxpayer has not worked on the land, e.g., built an extension or carried out a refurbishment, this indicates non-trading	5
(11)	<i>Turner v Last</i> 42 TC 517	Planning	If the taxpayer obtains planning permission, this may indicate trading	2
(12)	<i>IRC v Livingston</i>	Alterations	If the nature of the land interest is	2

	<i>n</i> 11 TC 538		altered, e.g., a lease extended, this may indicate trading	
(13)	<i>Cooke v Haddock</i> 39 TC 64	Nature of Land	Some land interests , by their very nature, indicate trading, e.g., building a housing estate, buying subject to a protected tenancy with a view to sale when vacant	2
(14)	<i>West v Phillips</i> 38 TC 303 <i>Simmons v IRC</i> (1980) STC 350	Reasons for Sale	Unanticipat ed reason for sale, e.g., unexpected offer, indicates non-trading	10
(15)	TMA 1970	Memory	Taxpayer has good memory – should help in defeating a trading	2

			attack by HMRC	
(16)	TMA 1970	Taxpayer alive	More likely to defeat trading attack by HMRC (mortui non mordent – dead man cannot give evidence)	4
(17)	<i>Marson v Morton</i> [1986] STC 463	Comprehension	Taxpayer does not fully understand the land deal – indicates not trading	1
(18)	<i>Marson v Morton</i> [1986] STC 463	JV/Partnership	Existence of a joint venture or partnership structure may indicate trading	1
(19)	<i>Taylor v Good</i> [1974] STC 148	Minutes	Super contemporaneous 'minutes' kept of intentions not to trade – powerful indicator of not trading	10

(20)	<i>Taylor v Good</i> [1974] STC 148	Age	Age of taxpayer – land (rent) is the ‘pension’ of client – indicator of non-trader	1
(21)	ITTOIA 2005 s.25 and s.272 and CTA 2009 s.576	Accountancy treatment	Can be very significant in relevant cases	10
(22)	<i>Ramsden v IRC</i> 37 TC 619 at 627, <i>Massey v Crown Life</i> (1978) 1 WLR 876 at 680	Labels	These can be important but cannot change the reality.	1
(23)	<i>Eclipse 35 v HMRC</i> [2015] STC 1429 [143]	Element of commercial risk	The more speculative the venture, the greater the chance of trading	1

(NB the weightings are the writer’s based on the reading of the cases).

In some cases – such as interest – the determination of the location of the source involves a vigorous exercise (*Ardmore v R&CC* [2018] STC 1487 CA).

If HMRC cannot get your income under any named source they have 2 routes available.

They can try ITTOIA 2005 s687(1) which taxes income “from any source” not falling under any other income tax head. This is a catch-all but it still requires a source.

Sir Launcelot Henderson in *Revenue and Customs Commissioners v BlueCrest Capital Management LP and others; Dodd and others v Revenue and Customs* [2024] STC 92 stated:

“[102] A further requirement, implicit in the wording of s 687, is that the income must arise from an identifiable source in the relevant tax year. This follows, in my judgment, from the opening words of sub-s (1), which impose the charge to tax on 'income *from any source* that is not charged to income tax ...'. The need for this requirement to be satisfied was

arguably left open by Viscount Cave in *Brown v National Provident Institution*, *Ogston v Provident Mutual Life Association* [1921] 2 AC 222 at 242, (1921) 8 TC 57 at 88–89, where he referred to Case 6 as a 'possible exception' to the general rule that 'an assessment for a year requires a taxable subject-matter in that year', commenting 'This may be so'. But any doubt on the point was in my opinion removed by the express wording of s 687(1). That was evidently the view of the Upper Tribunal (Zacaroli J and Judge Guy Brannan) in *Kerrison v Revenue and Customs Comrs* [2019] UKUT 8 (TCC), [2019] STC 614, [2019] 4 WLR 8, ('*Kerrison*') at [70], although they left the point open because it was not necessary for them to decide it.”

In the alternative HMRC can argue on the construction of the particular section no source is needed: there is simply an income tax charge.

In *Walker (Inspector of Taxes) v Centaur Clothes Group Ltd* [2000] STC 324 Lord Hoffmann stated:

“My Lords, I can find nothing in the language of the definition which requires the concept of "income" being within the charge to corporation tax to be restricted to income derived from a source within that charge. Still less is there reason to restrict the concept of a person being within the charge to persons having a source of income within that charge. The definition of a source of income within the charge to income tax or corporation tax is hardly technical or sophisticated. It says that a source is within the charge to income tax if the income from that source is, or would be, liable to income tax. And likewise for corporation tax. How does one give a similar construction to "income" and "a person?" I should have thought the answer was not difficult. **Income is within the charge to income tax if it is liable to income**

tax and within the charge to corporation tax if it is liable to corporation tax. And a person is within the charge to income tax if he is liable to pay income tax and within the charge to corporation tax if he is liable to pay corporation tax. I shall in due course consider the implications of this construction, but for the moment it will do.”

It is true that by s 9(3), the computation of income for the purposes of corporation tax is to be computed according to income tax principles and under the same Schedules and Cases. Income tax is traditionally a source-based annual tax, liability depending upon the existence of a source of income falling under one of the Schedules during the year of assessment: *Brown v. The National Provident Institution* [1921] 2 AC 222; 8 TC 57. If the income tax had retained that ancient simplicity, it would be true to say that income could not be within the charge to tax unless there was a source within the charge and a person could not be within the charge unless he had a source of income within the charge. But that would

be because of the nature of the income tax and not anything in the language of the definition.

It is however no longer true to say that liability to income tax depends upon the existence during the year of assessment of a source within the charge. There are cases (such as post-cessation receipts) when liability depends upon the existence of income defined by reference to a source which does not exist within the year of assessment. Or liability may depend upon an event, such as a balancing charge on the sale of an asset which has attracted a capital allowance, or the receipt of a capital sum from a particular kind of transaction, which is deemed to be taxable income received in that year of assessment or sometimes spread over several years of assessment. In the case of corporation tax, liability is also imposed upon chargeable gains. **So there is no longer any basis for assuming that income, or a person, can only be within the charge to corporation tax in a given year of assessment if the income is from or the person has a source of income within the charge to that tax.**

OFFSHORE INCOME FUNDS

In *Louwman v R&CC* [2026] SFTD 81 (this is being appealed to the upper tribunal) the question was whether an offshore income gain (an OIG) realised in a settlement was taxed under s687 (this required a source: if there was a source it would be foreign and the gain would not be taxable on the settlor) or was charged to income tax without there being source (as there would be no discernible foreign source the deemed income could be taxed on the settlor).

The FTT found for HMRC thus:

“**[35]** As regards the conclusion set out in para 34(1) above, we consider that the structure of the legislation makes it apparent that OIGs do not have a source. We say that because:

(1) OIGs are capital sums which are not actual income but are instead deemed to be income. As such, they are an example of a type of income which does not have a source in the traditional sense. In *Walker* at para 803F, Lord Hoffmann

gave, as a specific example of income which does not have a source, 'the receipt of a capital sum from a particular kind of transaction, which is deemed to be taxable income received in that year of assessment ...'.

CONCLUSION ON THE NEED FOR A SOURCE

The conclusion is there are many heads where a source is specified; even if one avoids those heads and s687 applies there still has to be a source; however, in cases where a gain of a capital nature is deemed to be an income receipt a source is not required.

GIFTS

Gifts cannot create a source. They cannot even fall within miscellaneous ITTOIA 2005 s687.

In *Scott v Ricketts* (1967) 2 ALL ER 1009 a company (Ravenseft) made a gratuitous payment under a contract and it was held this head did not apply. Denning MR at 1011 stated:

“The crux of the present case is that the taxpayer had no legal ground to be paid anything. All he had—to use the judge's words ([1966] 3 All ER at p 796, letter *h*)—was “a moral claim or a nuisance value.” Ravenscroft paid him £39,000 in order that he should not feel aggrieved, and to get rid of any possible claim. If they had paid this sum over to him as a gratuitous payment, it would not have come within Case VI; but because it was “dressed up” as a contract—to use the judge's own words ([1966] 3 All ER at p 796, letter *e*)—he has held that it is caught by Case VI. I do not think that that is right.”

WHAT DO YOU THINK? – GIFTS TO PROFESSIONALS FOR A JOB WELL DONE – TAX FREE?

If a self-employed person (solicitor, accountant, builder and the like) has done a good job for his client and been paid a good fee for his services and the client decides at a later date to pay him a further sum as a genuine “thank you” much to the surprise of the

self-employed person (who never solicited for the same), that “thank you” payment may be income tax free.

If the profits do not arise from a profession or trade they cannot be assessed under ITTOIA 2005 s5.

Thus, voluntary payments are IT free unless they attach to a source; *Benyon v Thorpe* [1928] 14 TC 1 at 13.

Simon’s Taxes summarises the position thus:

A1.122 Income must be derived from a designated source

.....it will be apparent that “receipts”, to use a neutral term, which are not derived from any of the sources designated in the taxing statutes are not chargeable to income tax. It is on this principle that many casual profits or increments are excluded from the charge. To take an example, if A, not being engaged in the trade of dealing in pictures, buys some pictures for the purpose of furnishing his house, and later sells any or all of them for

more than he paid, the resulting profit is not income chargeable to income tax, for there is no designated source from which such profit arises. If, however, B is a picture dealer and realises a profit from the purchase and sale of a picture, that profit is chargeable to income tax as trading income, because it is derived from a designated source, namely, the trade of dealing in pictures.

Once a profit of an income nature is shown to be derived from one of the designated sources, it becomes chargeable to income tax according to the rules applicable to profits from that source.

Gifts of money and voluntary payments are on similar grounds not income in the hands of the recipient.....

To determine the receipts taxability as income from a trade or profession one must ascertain the “nature (or character) of the receipt in the recipient’s hands.”

All relevant circumstances must be taken into account.” See *Murray v Goodhews* 52 TC 86 at 108H.

The payer’s intention in making the payment *may* provide evidence of the nature (character) of the payment in the recipient’s hands (*Rolfe v Nagel* [1982] STC 53). In Simon’s Taxes at B2.213 it is stated thus:

“It is the nature of the payment in the hands of the recipient which determines whether it is a receipt of his trade; the motive of the person making the payment is relevant only to the extent, if at all, to which it has any bearing on the nature of the receipt.”

HMRC state (writer’s emphasis):

**BIM40055 Receipts: General:
Excluded Revenue: Liability**

It should not be assumed that a sum received is a trade receipt solely because nothing would have been received had the trade not been carried on.

...Broadly speaking – and a one sentence summary is no substitute for the more detailed guidance referred to – the distinction is between money received in the capacity of trader; and that received in a personal capacity. Examples of sums received in a personal capacity are sums received because the recipient has suffered personal injury (compensation), **or because the receipt is nothing other than a personal “thank you” (voluntary payment)**

The nature of the receipt is not a profit of the trade or profession if the supplier is “paid in full for past work” and the payer “making the gift wishes to acknowledge the past conduct of the recipient” as deserving of the payment: see Templeman J as he was then in *McGowan v Brown* 52 TC 8 at 15G-I.

Again, Pennycuik J in *Walker v Carnaby* 45 TC 561 at 573C stated:

“voluntary payments were tax free if paid as “recognition of past services” and not

as “the consideration for any services rendered by the firm.”

If the supplier has been under-paid for a job or the supplier feels it warrants more than the amount agreed to be paid these are indications the payment is taxable. This is because one of the prime indicia of a gift is it must be “wholly unexpected and unsolicited.” See *McGowan* at 16C and Russell LJ in *Simpson v John Reynolds* 49 TC 693 at 712D.

Some emphasis was laid on the fact the business relationship had ceased in the above case before the payment was made.

In *Colin Collins* TCo2088 (an employment case) a gift was made to a former employee of a company 4 years after the employ ceased and 18 months after the shares in the employer were sold and it was held to be tax free. The parties had a continuing friendship, and the payment was unexpected and was not made by the employer itself. It also greatly exceeded the old salary of the employee (see para 77). It could not be said to have been paid to supplement a low salary (para 77 second bullet point).

If the payment (from a customer) is a supplement to the trader's professional income to keep the trader in business that is taxable (see *IRC v Falkirk* 51 TC 42 at 54A).

Again, in *Severne v IRC* 35 TC 649 the supplier got increased payments, for his supplies, gratuitously from the Ministry of Food and these were taxable as they supplemented the trader's milling profits and were designed to do so.

These 2 cases have led HMRC to put forward the following proposition in BIM41810:-

Voluntary payments designed in some way to augment the consideration payable for services whether past, present or future, are taxable.

Falkirk involved a client supplementing the supplier's trading income to keep it solvent so it (the client) could continue to receive supplies. *Severne* involved the Ministry supplementing a miller's trading income with payments which the Ministry was not required to pay. The payments were directly

focused on increasing the income of the business in question.

CONCLUSION ON SOURCE

References to source come up over and over again in the tax code: it is the starting point in determining whether there is an income tax liability.

THE RAMSAY PRINCIPLE IN 2026

Patrick Way KC

Speed read

This article describes how the Ramsay principle has developed over time. It concludes, unsurprisingly, with the observation that, in essence, the Ramsay principle is a rule of construction. Consequently, legislation is to be read on a purposive basis requiring the courts to identify the intention of the relevant statute and then to construe that legislation in accordance with the identified intention.

This process is to be carried out by the courts regardless of the particular way in which the transaction may have been implemented and in so doing the courts are to adopt a “realistic” method of construction. They are not to “blindly” follow the particular “steps” within the legislation if those “steps”, taken individually, conflict with the overriding intention of the legislation as identified by the courts.

Article

This article follows on from a lecture which I gave to the post-graduate tax students at Oxford University. Consequently, it concentrates on the points which were relevant for their syllabus.

What is tax avoidance?

It seems obvious, of course, that not all steps which a taxpayer might take to reduce their tax bill should be regarded as tax avoidance. Perhaps more appropriately, not all such steps should be regarded as “unacceptable tax avoidance”.

For example, the following steps ought to be uncontroversially satisfactory:-

- investing in an ISA;
- arranging, in respect of assets qualifying for business property relief, for there to be a rights issue of new shares rather than fresh issue. This allows the two-year ownership rule, within the business property rules, to be accessed “immediately”. See IHTA 1984 ss.106 and 107. Even this “technique” can be

controversial in certain circumstances nevertheless;

- making use of the £3,000 annual inheritance tax exemption.

But what about deferring or accelerating a significant bonus to avoid, let us say, an existing 50% income tax rate? When the 50% income tax rate was reduced to 45% (with effect from 6th April 2013) a number of bankers opted to push their annual bonus into that later year to benefit from the lower rate of income tax. The effect was to suffer a total marginal rate of income tax and national insurance of 53.4% rather than 57.8%.

At the time Sir Mervyn King, the departing Governor of the Bank of England, said:-

“I find it a bit depressing that people who earn so much seem to think its even more exciting to adjust the timing of it to get the benefit of a lower tax rate knowing this must have an impact on the rest of society.”

So that may be a situation falling between “acceptable” tax avoidance and “unacceptable” tax avoidance, depending upon your point of view.

The Duke of Westminster case

As everybody knows, the case of *Inland Revenue Commissioners v. Duke of Westminster* [1936] AC 1 is a seminal case. It established that taxpayers, at least at that time, could legally arrange their affairs to minimise their tax liability. In that case the House of Lords ruled that the legal form of a transaction prevails over its commercial “substance” or “purpose”, provided that the documents are genuine and not a sham.

The key facts were that the Duke of Westminster sought to reduce his surtax bill by replacing wages paid to his employees with deeds of covenant. These were legally binding promises to pay annual sums, regardless of whether the employees continued to work for the Duke.

By a 4:1 majority the House of Lords held that the payments in question were not wages but were valid annual payments. This therefore allowed the Duke to deduct them from his taxable income and achieve a tax benefit.

In that case Lord Tomlin famously stated as follows:-

“Every man is entitled, if he can, to order his affairs so that the tax attaching ... is less than it would otherwise be.”

This became known as the “*Westminster* doctrine”. It is fair to say, however, that this doctrine is well past its “sell by date”: it would be a brave (foolish) advocate that sought to rely upon this doctrine in court.

Gregory v Helvering

The case of *Gregory v Helvering* (293 U.S. 465 (1935)) is a very important United States Supreme case. It established that transactions must have a legitimate business purpose beyond tax avoidance in order to be valid. The US Court ruled that even if a transaction follows the literal letter of the law, nevertheless it could be disregarded if it lacks economic substance.

The relevance of this American case is that it “caught the eye” of a number of tax advisers including, in particular, Peter Millett QC (as he then was). He considered that the ratio of *Gregory v Helvering* could be utilised in connection with his aim to

challenge tax avoidance within the United Kingdom; in effect, he sought to apply the fundamental rule of *Gregory v Helvering* to UK tax avoidance.

In the *Gregory v Helvering* case the taxpayer (Evelyn Gregory) created a shell corporation (Averil Corporation) to transfer assets from her company to herself. In this way she sought to disguise a taxable dividend as a tax-free organisation under the 1928 Revenue Act.

The United States Supreme Court, led by Justice Sutherland, held that while taxpayers had the right to decrease their taxes, the relevant statute applied exclusively to bona fide business organisations and not to devices to transfer shares.

This case may therefore be said to be the source of the “business purpose” doctrine and the “substance over form” principle which allowed the IRS to ignore tax-driven transactions lacking economic reality. Also, more relevantly for this article, it was the catalyst for Peter Millett QC (subsequently famously, of course, Lord Millett) to seek to introduce a similar principle into the UK tax avoidance arena in his capacity as Leading Counsel for the Inland Revenue in relevant tax avoidance cases.

The Ramsay case

The *Ramsay* case (*WT Ramsay Ltd v. IRC* [HL 1981] 54 TC 101) is of course the case that lies at the heart of this article. Following on from the above-mentioned American case the principal doctrine of *Ramsay* is that it allows courts to disregard artificial pre-ordained steps in tax avoidance schemes. More particularly, rather than considering steps in isolation, the courts will view a transaction as a whole to identify, and then tax, its real economic result.

In this respect, the *Ramsay* principle is a method of statutory interpretation since it views the relevant legislation's purpose, and the facts, "realistically". Further, if steps are inserted into a scheme purely to avoid tax, and have no other commercial purpose those steps can be disregarded and the result (absent the excised steps) can then be taxed.

So, it is important to note that the judges consider the *Ramsay* principle to be a rule of construction requiring them to construe the legislation by reference to its assumed purpose.

Craven v White

The next key case is the case of *Craven v White*

([1988] STC 476).

In this case the House of Lords (for a short period at least) narrowed the scope of the *Ramsay* principle by establishing what I call the “cliff edge approach”. More particularly, the ruling in *Craven v White* was to the effect that a series of transactions could not be treated as a single composite transaction (within the *Ramsay* principle), after all, if the steps were not pre-ordained at the time of the first transaction. This was the case even if those steps were designed to avoid tax. So the *Ramsay* principle had “its wings clipped” at least for a short time.

The reason I call it the “cliff edge approach” is that provided that when the steps were taken the taxpayer could “stop”, at any time, and then “turn back” without “falling over the edge of the cliff”, then, if you like, the steps cannot have been pre-ordained.

By contrast, the *Ramsay* principle would apply (by reference to the ratio in *Craven v White* as it applied at the time and for a short period afterwards) only if, once the steps had started, the taxpayer was committed to finishing them off.

In the *Craven v White* case the shareholders in a particular company wanted to sell their shares. They

exchanged those shares for shares in an Isle of Man company and then the Isle of Man company sold the shares in the target company to a third party purchaser.

HMRC argued, by reference to the *Ramsay* principle, that the exchange of shares into the holding company followed by the subsequent sale should be treated as one single sale triggering capital gains tax. The House of Lords held by a 3:2 majority that the *Ramsay* principle, as mentioned, did not apply, in circumstances where there was a genuine break in negotiations and – more generally – where it was not pre-ordained that all of the steps would take place in due course.

The Good case

I am now jumping ahead to more recent cases and the *Good* case and the case which follows, namely, *Hargreaves*. *Good* considers the meaning of the word “entitlement”; and *Hargreaves* considers the meaning of the expression “beneficial entitlement” which is a “term of art”.

In the *Good* case the Court of Appeal considered that “entitlement” and “receipt” were different concepts to such an extent that they held that you could be

“entitled” to income even if it was impossible for you ever to “receive” that income. In a nutshell, this was because you might benefit from someone else’s receipt to such an extent that that produced “entitlement” for you.

Compare this with the *Hargreaves* case where it was held that you do not beneficial entitlement even if you receive £50m. into your bank account for a short period of time where that receipt is subject to an obligation to pay virtually all of it away. More particularly, the fact that you were bound to pay nearly all of it away meant that you were nothing more than a conduit and that did not give you “beneficial entitlement”.

So, let’s start with the *Thomas Good* case (*Thomas William Good v HMRC* [2023] EWCA Civ 114). Here, an individual assigned his income from a film scheme to a lending bank once and for all. Notwithstanding the fact of this assignment of the income, the Court of Appeal held that the individual had retained entitlement to the benefit of the income. So on this basis the taxpayer was “entitled” to the income paid away to the bank even though he never received it.

In the case Whipple LJ said at paragraph 62:-

“62 The taxpayer derived a clear benefit from the [income being the Minimum Annual Payments defined as “MAPs”] each time they were paid while the Loan remained outstanding sufficient to mean that the taxpayer remained “entitled to” the MAPS for the purposes of s.611.”

In other words, even though the taxpayer in *Good* had not received the MAPs (they had been directed to be paid to the Lender) he was still entitled to the MAPs and indeed “*derived a clear benefit*”.

The Hargreaves case

In the *Hargreaves* case (*Hargreaves Property Holdings Ltd v HMRC* [2024] EWCA Civ 365) (the meaning of a slightly different expression “beneficially entitled” was at stake. That *was* a term of art.

A company sought to pay interest to a Guernsey company (which crucially was UK-incorporated) in circumstances where by dint of that recipient company’s UK tax residence there would no

obligation on the paying company to withhold interest pursuant to the provisions of ITA 2007 s.874. (The obligation to withhold income tax in respect of payments of certain interest does not apply if the recipient is UK tax resident as the “Guernsey” company was – ITA 2007 ss.930 and 933.) Its incorporation in the United Kingdom rendered it UK tax resident (Corporation Tax Act 2009 s.14).

It was certainly the case that interest had been paid to the relevant company (which was UK resident) but that interest had remained with the company for a very short period of time indeed before almost all of it was paid away. The Court of Appeal held that the recipient company was not beneficially entitled to the interest given the very short period of time in which the interest was held within the recipient company’s bank account. The decision took account, of course, of the overall tax avoidance motive: to avoid the obligation to withhold income tax on the interest paid.

In the *Hargreaves* case, the *Ramsay* principle was, therefore, applied to tax what were held to be artificial tax motivated steps. More particularly, the judgment held that beneficial entitlement in these

circumstances required a “real and practical entitlement” not just a limited period of ownership.

What if the avoidance in Good and Hargreaves had been “the other way round”?

To demonstrate how the *Ramsay* principle is “overbearing” (regardless of a “black letter” reading of the legislation in question) I thought it might be illuminating to consider *Good* and *Hargreaves* as if the taxpayer, and HMRC, were running each other’s arguments as to the meaning of “entitlement” and “beneficial entitlement” respectively.

So, had it been necessary for the taxpayer in *Good* to submit, after all, that he *did* have “entitlement” to the film income (in order to win his case of course) then in my view the Court of Appeal would have applied *Ramsay* “back to front” and held that he never had any such entitlement. This, in my view, would have been because, of course, he had assigned the income away in the first place!

And had the taxpayer in *Hargreaves* submitted, after all, that it did *not* have beneficial entitlement to the £50m. interest which it received then in my opinion the Court of Appeal would have applied *Ramsay* back to front again. In my view, they would have held

that the relevant company was beneficially entitled to the income even though it was obliged to pay it away. In this respect, the Court might well have cited the case of *Bupa Insurance Ltd v HMRC* (UT [2014] UKUT 262 (TCC); [2014] STC 2615). In that case a company was held to have beneficial entitlement of significant amounts of money even though it was obliged, by contract, to pay away the monies in question – just like the situation in *Hargreaves* you might say!

Hurstwood Properties

In the case of *Hurstwood Properties (A) Ltd v Rossendale Borough Council* ([2021] UKSC 16) there was a (frankly egregious) scheme to avoid liability to business rates on empty properties. It seems that various steps were taken which were described by the Supreme Court as having been created with the aim of acting unlawfully and abusing procedures provided by a company in insolvency law.

In this case, the Supreme Court held that the *Ramsay* principle required that the relevant leases in question should be examined in the context and in the light of the purpose of the legislation. It could not possibly have been the case that Parliament intended that “the

person entitled to possession” of unoccupied property should include a company with no real ability to exercise its legal right to possession and which had been granted that right for no purpose other than the avoidance of rates.

I think we can all agree that *Hurstwood* is a pretty rotten case!

Regroup

So, we have come a long way since the *Ramsay* principle came into play and we can remind ourselves of this by looking back to 2005, before we look at more recent evidence.

Lord Hoffmann

In an article called “Tax Avoidance” which is found in [2005] BTR 197 Lord Hoffmann said as follows:-

“... tax avoidance in the sense of transactions successfully structured to avoid a tax which Parliament intended to impose should be a contradiction in terms. The only way in which Parliament can express an intention to impose a tax is by statute that means such a tax is to be imposed. If that is what Parliament

means, the courts should be trusted to give effect to its intentions. Any other approach will lead us into dangerous and unpredictable territory.”

This statement of Lord Hoffmann seems remarkably “quaint” not to say “out of date” following what has happened subsequently. By this I mean that it is “out of fashion”, let us say, to state that “the only way in which Parliament can express an intention to tax is by statute” – something which (at least to me) seems both obvious and reasonable.

What I would say is that the effect of the *Ramsay* principle – now – is that the relevant legislation can be read by reference to its purpose as identified by the Court no matter what the legislation involved actually otherwise says “on a black letter basis”.

The D’Arcy case

In the case of *HMRC v D’Arcy* (ChD 2007, [2008] STC 1329), we find planning involving the accrued income scheme and the sale and repurchase of gilts resulting in the taxpayer being able to access a significant tax advantage with no corresponding economic expense, in circumstances where Henderson J said:-

“In short, this is in my view one of those cases, which will inevitably occur from time to time in a tax system as complicated as ours, where a well-advised taxpayer has been able to take advantage of an unintended gap left by the interaction between two different sets of statutory provisions.”

Or as the judge might have said: “The rule of law holds sway in this case whether I like it or not (*and I probably don't like it*)”.

But let's leave “*Ramsay and the rule of law*” for another occasion!

Barclays Mercantile case

The following sets out a more recent analysis of the *Ramsay* principle and is much more in keeping with the way in which modern judges apply the principle.

In the *Barclays Mercantile* case ([2002] EWCA Civ 1853, [2003] STC 66) it was said as follows:-

“The essence of the new approach was to give the statutory provision a purposive construction in order to determine the nature of the transaction to which it was

intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description. ... As Lord Nicholls of Birkenhead said in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311, 320, para 8: 'The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case.'

Further, in the *Barclays* case, Carnwath LJ said at para 66:-

[Taxing statutes generally] “draw their life-blood from real world transactions with real world economic effects”.

Following on from this, as Carnwath LJ also stated:-

“[that] to allow tax treatment to be governed by transactions which have no real world purpose of any kind is inconsistent with that fundamental characteristic.”

Finally, reference should be made to the words of Ribeiro PJ said in *Collector of Stamp Revenue v Arrowsmith Assets Ltd* [2003] HKCFA 46; (2003) 6 ITLR 454. He said, at para 35, that where schemes involve intermediate transactions inserted for the sole purpose of tax avoidance, it is quite likely that a purposive interpretation will result in such steps being disregarded for fiscal purposes.

Conclusion

It seems to me that we have reached the stage now where the judges will simply ensure that no tax avoidance scheme ever works.

They will do this by using the *Ramsay* principle in whatever way they like to do down tax avoidance. All that the judges have to do is to hold that the scheme involved could not be held to fall within what Parliament intended which they can do, notwithstanding the letter of the law. In effect, the judges will prefer to apply their own analysis rather than applying a specific “black letter” approach to the wording of the relevant statute.

Some people have said that this is the “Humpty Dumpty” principle:-

“When I use a word,’ Humpty Dumpty said in rather a scornful tone, ‘it means just what I choose it to mean — neither more nor less.’

Lewis Carroll, *Through the Looking Glass*

By way of conclusion, where I consider that we are in relation to the *Ramsay* principle is that the courts have effectively reserved to themselves very wide powers of interpreting legislation by reference to the purpose of the legislation as they identify it. This means that they are categorically not obliged to “follow blindly” the specific wording of legislation. This is clearly a good thing for UK Plc as it is desirable that tax avoidance is curtailed.

Nevertheless it does make one wonder what is the point of finely-honed tax legislation (now running to approximately 23,000 pages). Why bother with it?

After all, the effect of the *Ramsay* principle is that the details of legislation (including, in particular, tax legislation) can be ignored by the courts where a taxpayer has applied the strict letter of the law literally in order to obtain a tax advantage.

More particularly, why not enact a new piece of legislation. Let us call it “The Ramsay Act”.

This Act could specifically require that tax legislation be read on a purposive and realistic basis. It could give *carte blanche* to the courts to identify and apply their interpretation of the legislation in whatever way was necessary in order to negate tax avoidance.

Not only would this bring an end to litigation in respect of tax avoidance it would certainly save a forest of trees being cut down annually in order to provide the necessary paper for the annual editions of the Yellow and Orange tax books.

What’s not to like!

PROVISIONS
Deductibility for corporation tax
Peter Vaines

The Court of Appeal has now heard the appeal from the Upper Tribunal in the case of *AD Bly Groundworks and Civil Engineering Ltd v HMRC [2025] EWCA Civ 1443* which was concerned about whether a provision for future pension payments was deductible for corporation tax.

It is generally accepted that the costs of remuneration and benefits for employees are nearly always deductible from the company's profits under section 54 CTA 2009 as being:

“incurred wholly and exclusively for the purposes of the trade.”

However, this is not necessarily always the case. This was demonstrated by the Court of Appeal in *Hoey v HMRC [2022] EWCA Civ 656* in which they said:

“For example, the wages may be deliberately inflated so as to confer a personal benefit on the employee or with the object of artificially reducing the

employers taxable profit”.

This would seem to be an extreme example because there is lots of authority to the effect that expenditure incurred with a tax motivation does not involve a duality of purpose so as to disqualify the expense. Indeed, this principle was acknowledged in *Hoey* where it was said that even engaging in a tax avoidance scheme did not amount to a separate object of the employers in making the payment.

In *AD Bly* the Upper Tribunal did not need to dwell on duality of purpose (which is the usual issue relating to deductible expenditure). They refused a deduction on the grounds that the primary purpose of the company was not to benefit the employees, but to reduce their liability to corporation tax without incurring actual expenditure. As a result, the deduction was disallowed by the Tribunal, which perhaps indicates that the company may have rather overdone things. The Court of Appeal agreed, and the company’s appeal was dismissed.

That all seems quite normal and explicable and perhaps not worthy of much comment. However, there is a puzzling aspect to this case which was not addressed in the Upper Tribunal or the Court of

Appeal and I would respectfully suggest that the right conclusion may have been reached for the wrong reasons.

It is worth repeating that the issue in his case was whether a provision in the company's accounts in respect of liabilities to make future pension payments was deductible for corporation tax purposes under section 54 on the grounds that the expense was:

“incurred wholly and exclusively for the purposes of the trade”

There was no suggestion that there was anything wrong with the provision. Among other things, it satisfied the tests for a valid provision set out in the HMRC Business Income Manual at paragraph BIM 46250. The issue was simply whether it was an allowable deduction from the company's profits for corporation tax purposes.

However, it was a *provision* – which is a figure that the accountants considered the company would probably have to pay some time in the future. A provision is not (as it seems to have been assumed) synonymous with the incurring of an expense.

Section 54 expressly requires the expense to be

“incurred”, and the Tribunal confirmed that no expense had been incurred. They said:

“We think that it would have been more accurate for the FTT to have referred to the incurring of actual expenditure in the accounting period in which the deduction arose for tax purposes, since in AD Bly’s case it did incur some of the expenditure albeit in subsequent accounting periods.”

In other words, the company had not incurred the expenditure in the accounting period for which it made the claim. It is perhaps relevant to point out that if the company had incurred an expense and it remained unpaid, that would not have given rise to a provision – it would have been a *creditor*.

So, all the arguments in this case about whether the expenditure was wholly and exclusively for the purposes of the trade must surely have been irrelevant. The amount claimed by the company was not incurred in that accounting period so obviously it could not be allowed as a deduction. The expenditure was actually incurred in a later accounting period – and it is that later accounting period where the issues of wholly and exclusively would be relevant.

It may be thought that my analysis is unrealistic because accounts always contain provisions for something; they have to because of the need to show a true and fair view (at least as far as companies are concerned). And section 46 CTA 2009 specifically provides that trading profits must be calculated in accordance with generally accepted accounting practice. HMRC do not routinely enquire into companies' accounts for the purposes of disallowing provisions; on the contrary, provisions are routinely allowed.

Be that as it may, section 46(1) does cover this point:

“The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes.”

It is well known and accepted that entertaining expenses are not deductible (nor depreciation and various other items of expense). They are disallowed because they are adjustments required or authorised by law in calculating profits for corporation tax purposes. So it is with provisions. Section 54 is very

specific in requiring a disallowance of costs which have not been “incurred”.

It is perhaps fair enough for HMRC to allow a deduction for provisions on a routine basis under their care and management powers even though they may not be strictly allowable. However when the issue comes before the courts, the law must surely prevail. After all in the celebrated words of Walton J:

‘One should be taxed by law, and not be untaxed by concession’.

IHT AND PENSIONS

An Update

Peter Vaines

In the FCTC Digest No 26 published in February, I set out the rules proposed in the Finance Bill to bring pension entitlements into charge to IHT on 6th April 2027.

The widespread concern was that if the pension fund is subject to 40% IHT and then income tax at rates of up to 45% are charges on the drawing of the pension, this would be serious double taxation.

Fortunately, the Finance Bill included a deduction for the IHT against the amount of the pension income chargeable to income tax, which had the effect of reducing the overall tax rate considerably – to our great relief.

However, (and very unfortunately) the Finance Bill was subsequently amended and the Finance Act 2026 now contains some very different provisions.

Without going through all the changes line by line, I would explain that the final version means that for

deaths under age 75, the IHT deduction works fine, just as before.

If the pension fund is £1000 and the IHT is £400 there is only £600 left and when that is paid out as pension there is a deduction from the £600 pension income for the £400 IHT paid. So only the balance of £200 is charged to income tax – resulting in an extra £40 for a basic rate taxpayer, giving a total effective rate of 44% – and an effective rate of 48% and 49% for higher rate taxpayers. Not great, but nothing like as bad.

However, on a death after 75 there is now a restriction which denies the credit for the IHT paid by the pension fund. So the pension fund of £1000 pays the IHT of £400 leaving £600 to be paid out as pension income and chargeable to income tax at rates up to 45% – and we are back to a total tax burden of 67%.

You can get credit for the IHT if you pay it personally – but that does not help. It leaves the pension fund with £1000 to pay out and not just £600. That results in income tax after the IHT credit of £120 (i.e. total tax of £520 which is 52%), or £240 (total tax £640 which is 64%) or £270 (total tax £670 which is 67%).

Anybody over the age of 75 who has not yet drawn their pension is likely to regard this as a tad unsatisfactory.

Having followed the rules scrupulously for 50 years in saving for his pension (which is supposed to be a Good Thing) he now finds he may lose two thirds of it because the Treasury has changed the goalposts.

THE “THERAPEUTIC” THRESHOLD:

***Illuminate Skin Clinics* and the VAT line between care and cosmetics**

Dilpreet K. Dhanoa

“Beauty is no quality in things themselves: It exists merely in the mind which contemplates them; and each mind perceives a different beauty.”¹

Introduction

The recent Upper Tribunal decision in *Illuminate Skin Clinics Limited v HMRC* [2025] UKUT 341 (TCC) is a reminder that VAT is not concerned with beauty as such. Nor is it concerned with whether a patient feels better after treatment. The statutory question is narrower and more exacting: did the supply consist in the provision of medical care?

The Upper Tribunal’s decision is a significant one for the VAT treatment of aesthetic and cosmetic medical services. It does not decide that non-surgical aesthetic treatments are exempt. Nor does it decide that they are necessarily taxable. Its importance is

¹ David Hume, *Of the Standard of Taste*, 1757.

more precise: it identifies the test to be applied where a treatment has both a cosmetic purpose and a possible therapeutic purpose, and it explains what evidence may be needed to bring such a supply within the exemption for medical care.

In the author's view, it is likely to become the leading domestic authority on the VAT treatment of aesthetic medicine. The case asks a deceptively simple question: when a registered medical practitioner provides a treatment with an aesthetic purpose or effect, when — if ever — is that treatment exempt from VAT as “medical care”.

The answer is neither taxpayer-friendly nor HMRC-absolutist. The Upper Tribunal did not hold that aesthetic treatments are exempt merely because they are performed by a doctor. Equally, it did not hold that cosmetic effect is fatal to exemption. The decision is more nuanced, and therefore more troublesome in practice. Where a supply has both a therapeutic purpose and a cosmetic purpose, the tribunal must identify the *principal purpose* of the supply. That exercise is objective, evidential, and intensely fact-sensitive.

The practical consequence is that one familiar line of argument – that treatment by a suitably qualified medical practitioner, directed at patient wellbeing, is medical care – is now markedly narrower. For clinics, advisers and litigants, the battleground will be diagnosis, records, symptoms, marketing, patient understanding, practitioner judgment and the medical link between the treatment and the condition said to be treated.

This article examines the decision and its practical implications for those advising aesthetic clinics, medical practitioners and taxpayers seeking to bring cosmetic-adjacent treatments within the VAT exemption.

The issue: when is beauty treatment medical care?

The facts were commercially familiar. Illuminate Skin Clinics operated a private clinic offering aesthetic, skincare and wellness treatments, including treatments for collagen loss, excess fat, Botox and dermal fillers. The services were provided by Dr Sophie Shotter, a qualified doctor registered with the General Medical Council. The professional-status condition was therefore not the real issue. The issue was whether the supplies consisted in the

provision of “medical care” within Item 1, Group 7, Schedule 9 VATA 1994.

HMRC had refused a repayment claim and assessed VAT. The FTT dismissed Illuminate’s appeal, concluding that its supplies did not constitute medical care. Illuminate appealed to the Upper Tribunal. The case was recognised as a lead case, with a number of other cases stayed pending the outcome.

The statutory provision is familiar but sparse. Item 1, Group 7, Schedule 9 exempts: “The supply of services consisting in the provision of medical care” by a person registered or enrolled in one of the listed medical or healthcare registers.

That wording does two things. It requires the relevant services to be provided by, or through, an appropriately registered healthcare professional. However, it also requires the supply itself to consist in medical care. Illuminate’s difficulty lay in the second limb. A doctor may supply medical care; but a doctor may also supply something else.

The core legal dispute was therefore this: does a cosmetic or aesthetic treatment fall outside the exemption only if it is purely cosmetic, or must the

taxpayer show that the principal purpose of the supply is therapeutic?

The decision: principal purpose over cosmetic effect

The question before the Upper Tribunal was an awkward one. A treatment may change a patient's appearance. It may also address a recognised medical condition, or the effects of disease or prior medical treatment. At what point does aesthetic medicine become medical care for VAT purposes?

The Upper Tribunal rejected Illuminate's broader "purely cosmetic" test. The fact that a treatment has some therapeutic element is not enough. If the cosmetic purpose is the principal purpose, the supply is not exempt. If the therapeutic purpose is the principal purpose, the supply may be exempt. That is the central holding, and two consequences follow.

- (i) First, cosmetic effect is not fatal. A procedure may improve appearance and still amount to medical care. For example, a Botox treatment directed to diagnosed tension headaches may, depending on the evidence, have a therapeutic principal purpose. A treatment addressing the side effects of earlier medical treatment may

also, depending on the evidence, require careful analysis.

- (ii) Secondly, medical context is not enough. A supply is not exempt merely because it is delivered by a doctor in a clinical environment, after a consultation, using medical products, with some general benefit to confidence or wellbeing. The exemption is not for “doctor-led services”. It is for medical care.

The Upper Tribunal’s approach keeps the spotlight on purpose. Not broad commercial purpose in the abstract; not the purpose of the clinic’s business generally; but the principal purpose of the specific supply. The question is not “what sort of business is this?” but “why was this treatment supplied to this patient, in these circumstances?”

The point of relevance is that where there are mixed purposes, the Tribunal must identify the principal purpose of the supply. That inquiry is not mechanistic. It requires a multi-factorial assessment, likely to include:

- (i) any diagnosis made by the medical practitioner;

- (ii) the nature of the disease or medical disorder diagnosed;
- (iii) the symptoms exhibited by the client;
- (iv) the intrinsic nature of the procedure;
- (v) the circumstances in which the client consulted the practitioner, including context and marketing;
- (vi) the client's understanding of the aim of the procedure; and,
- (vii) the practitioner's understanding of the aim of the procedure, including any prophylactic aim.

In the author's view, this list is likely to become the working checklist in future cases. It is also where many claims will either be made or lost.

The subjective understanding of the client is relevant, but not decisive. A patient who wants to look better may nevertheless be receiving medical care. Conversely, a patient who feels better after an aesthetic treatment has not necessarily received medical care. The medical assessment of an appropriately qualified practitioner is likely to be

more significant; but even that is not determinative. The question remains: what was the principal purpose of the supply?

A clinic cannot simply rely on the fact that the treatment is capable of having a therapeutic use. Nor can HMRC simply point to the aesthetic effect and stop there. The tribunal must examine the actual supply. The presence of a wart, scar, tension headache or chemotherapy-related side effect may alter the analysis. But the label on the treatment – “Botox”, “filler”, “skin tightening”, “collagen stimulation” – will not itself decide the VAT treatment.

The Tribunal’s answer was that the exemption requires a therapeutic purpose. Where the supply has *both* a therapeutic purpose *and* a cosmetic purpose, it is necessary to identify the principal purpose of the supply. It is not enough that there is some incidental or subsidiary therapeutic benefit. Equally, it is not right to say that the presence of any cosmetic element excludes the exemption. The answer lies in a fact-sensitive, supply-by-supply assessment.

That conclusion is important because Illuminate had argued for a different approach. It submitted that, on the authority of *PFC Clinic AB*, a cosmetic treatment falls outside the exemption only where it is “purely cosmetic”. On that analysis, if there is any therapeutic purpose, the exemption may apply. The Upper Tribunal rejected that broader proposition. It held that *PFC* does not mean that the existence of any therapeutic purpose is sufficient, regardless of whether that purpose is merely subsidiary to the cosmetic purpose.

In short: the same product may be taxable in one case and exempt in another. The tax analysis follows the purpose of the supply, not the brand name of the treatment.

Diagnosis: important, but not a tax ritual

The Tribunal began from orthodox principles. VAT exemptions are exceptions to the general rule that VAT is chargeable on taxable supplies. They must therefore be interpreted strictly. But strict interpretation does not mean the most restrictive interpretation. The medical care exemption must be construed consistently with its purpose: reducing the

cost of medical care and making such care more accessible.

That balance matters. HMRC cannot simply say that an aesthetic clinic is outside the exemption because the setting is commercial, private or beauty-adjacent. Nonetheless the taxpayer cannot say that a registered medical practitioner's involvement is enough. The exemption is not for all supplies by doctors. It is for supplies of medical care.

Diagnosis was the most practically important aspect of the decision. The Upper Tribunal accepted that medical care generally follows diagnosis. Where a taxpayer says that a treatment was supplied to treat a disease or health disorder, one would ordinarily expect to see a diagnosis. If there is no diagnosis, the taxpayer must offer cogent reasons why the treatment is nevertheless said to have a therapeutic aim. Without a diagnosis, or cogent reasons for its absence, it will be difficult to show that the principal purpose of the procedure was therapeutic.

However, the Tribunal also held that the FTT set the bar too high. A diagnosis need not be elaborately recorded. It need not be contained in a "scientific document". Some diagnoses are straightforward. A

wart or verruca may be diagnosed after a short consultation. Other conditions will require more careful investigation and more detailed records. The evidential burden depends on the nature of the alleged condition and treatment.

That was where Illuminate succeeded. The FTT had placed no weight on initial consultation documents as evidence of diagnosis. The Upper Tribunal held that this was an error of law. The documents may have been cursory, but on their face they evidenced diagnoses by Dr Shotter. Where she diagnosed a recognised medical disorder which she was qualified to diagnose, that was relevant to the multi-factorial assessment of principal purpose.

The point is a narrow but important one. Illuminate did not win because its treatments were held to be exempt. It won because the FTT had wrongly disregarded evidence which might have mattered.

The trap for aesthetic clinics: Cosmetic purpose is not fatal; wellness is not enough

The practical danger for aesthetic clinics is that Illuminate gives with one hand and takes with the other. The decision draws a practical boundary

between medical care, cosmetic improvement and general wellness.

On the one hand, it confirms that cosmetic appearance and medical care are not mutually exclusive. A treatment with an aesthetic effect may be medical care if its principal purpose is therapeutic. That is helpful. On the other hand, it makes clear that the exemption will not be available merely because the treatment is provided by a doctor, the patient feels better afterwards, or the clinic can describe the procedure in medical language. That is the trap.

A procedure to treat tension headaches with Botox may, depending on the evidence, have a therapeutic principal purpose. A procedure to address collagen loss following chemotherapy may also require careful analysis. By contrast, treatment aimed at improving self-esteem or confidence, without a diagnosis or other indication that it is treating or preventing a recognised mental health condition, will not ordinarily be medical care.

The Tribunal accepted that psychological disorders can fall within the concept of medical care. But it is not enough to say that a treatment makes someone

happier or more confident. The taxpayer must show a recognised psychological disorder and an appropriate treatment relationship between the procedure and that disorder.

That distinction is likely to be important in practice. Aesthetic medicine often trades in the language of confidence, wellbeing and self-image. For VAT purposes, that language may be unhelpful unless it is tethered to a recognised disease, disorder, symptom, risk or consequence of treatment.

Three propositions which may once have appeared attractive to taxpayers now require significant caution:

- (i) First, “the patient felt better” is not enough. The Tribunal endorsed the distinction between treating a recognised mental health condition and improving self-esteem or confidence. Helping a person feel better about their appearance is not, without more, treating that person’s mental health. In the absence of a diagnosis or other indication that the procedure is preventing or treating a

mental health condition, the supply will not fall within the exemption.

- (ii) Secondly, “the practitioner is a doctor” is not enough. The supplier’s registration is necessary, but not sufficient. A GMC-registered doctor may supply exempt medical care. But if the treatment’s principal purpose is cosmetic, the exemption still fails.
- (iii) Thirdly, “there is some therapeutic benefit” is not enough. *Illuminate* rejected the idea that any therapeutic element prevents the supply from being taxable. The question is not whether a therapeutic benefit exists somewhere in the background. The question is whether the therapeutic purpose is the principal purpose.

The result is likely that clinics will need to be much more disciplined in separating medical cases from cosmetic cases. A generalised clinic policy will rarely be enough. The analysis must be patient-by-patient and treatment-by-treatment.

The mental health boundary

The most sensitive part of the decision concerns psychological benefit. Many aesthetic procedures are sold, described or understood by patients in terms of confidence, self-image and emotional wellbeing. That may be commercially true. But it is not, by itself, enough for VAT exemption.

The Tribunal accepted that treatment of psychological disorders can amount to medical care. The taxpayer must show, at least, a recognised psychological disorder or sufficiently specific risk, and a proper medical link between the procedure and the treatment or prevention of that disorder. A patient being “a bit depressed” about appearance, or hoping to feel happier after treatment, is not the same as medical treatment of a diagnosed disorder.

This is likely to matter in practice. Clinics should be cautious about relying on broad wellbeing narratives. Marketing language that emphasises confidence, rejuvenation, empowerment or feeling better may help sell the service. It may also help HMRC show that the principal purpose was cosmetic or wellness-based rather than therapeutic.

In short: “wellness” is not a VAT exemption.

The remittal: victory, but not vindication

The Upper Tribunal allowed the appeal on Ground 3, set aside the FTT's decision, and remitted the matter to the FTT. It did not remake the decision. It did not hold that Illuminate's supplies were exempt. It decided that the FTT's error — placing no weight on documents evidencing diagnoses — might have made a difference. That distinction is important. The remitted question is whether, applying the correct multi-factorial approach, particular supplies amounted to medical care. HMRC's VAT appeals update records the current status as: appeal allowed by the Upper Tribunal and remitted to the FTT.

That outcome should not be misunderstood. Illuminate won the appeal because the FTT's reasoning was legally flawed, not because all or most of its treatments were necessarily exempt. The decision gives the taxpayer another opportunity. It also gives HMRC a clearer framework.

Illuminate is not a green light for aesthetic clinics to treat their supplies as exempt. Nor is it a blanket endorsement of HMRC's approach. It is a framework case. It tells tribunals how to analyse mixed aesthetic and therapeutic supplies. It tells taxpayers what

evidence they need. It tells HMRC that cosmetic context is powerful but not conclusive. The outcome on remittal will depend on the evidence relating to specific supplies.

Practical implications

Three practical implications strike the author as essential for advisers in the 2026 climate of VAT enforcement and litigation.

- (i) “Aesthetic” is not a tax test. Aesthetic effect does not automatically defeat exemption. But aesthetic purpose may do so. The distinction is critical. A treatment may improve appearance because it treats an underlying disorder or symptom. Equally, it may use medical techniques to achieve a cosmetic result. The statutory question is whether the supply consists in medical care. The practical question is whether the therapeutic purpose is principal.
- (ii) Records are likely to decide many cases. The consultation record is no longer administrative housekeeping. It is tax evidence. If exemption is claimed, the file

should show the condition diagnosed or suspected, the symptoms, the medical rationale for the treatment, the practitioner's clinical judgment, and the link between the treatment and the disorder or health risk. The record need not be elaborate in every case. But it must be sufficient for a tribunal to see why the treatment was medical care rather than cosmetic enhancement.

- (iii) Marketing can undermine the exemption. The Tribunal's multi-factorial test expressly includes the circumstances in which the client consulted the practitioner, including context and marketing. That matters. A clinic cannot market a procedure as rejuvenation, beautification or confidence enhancement, and then expect the tax analysis to proceed as if the supply were obviously therapeutic. Marketing is not determinative, but it is evidence of purpose.

Two further cautions are worth stating: first, mixed-purpose supplies are not solved by asserting dual purpose. Dual purpose is where the real inquiry begins. The more cosmetic and therapeutic purposes coexist, the more important the evidence becomes. Secondly, mental health arguments require particular care. A recognised psychological disorder may bring a case within medical care. A desire to feel better about appearance will not.

For clinics, the practical lesson is simple but demanding: the VAT analysis must be done *per supply*, not by broad treatment category alone. “Botox” is not inherently exempt or taxable. “Dermal filler” is not inherently exempt or taxable. The question is why the treatment was supplied, what condition or risk it addressed, and whether that therapeutic purpose was principal.

Conclusion: a final observation

Illuminate is a useful decision because it resists two false simplicities. The first is that aesthetic medicine is merely beauty treatment and therefore outside the exemption. The second is that treatment by a doctor is medical care and therefore exempt. Both propositions are wrong.

The better view is more fact-sensitive and less convenient. The exemption turns on purpose; purpose is proved by evidence. In mixed-purpose cases, the decisive question is whether the therapeutic purpose is the principal purpose. The answer will often lie not in the label attached to the treatment, but in the patient record, the diagnosis, the reason for the procedure and the clinical judgment made at the time.

For VAT practitioners, that is the lasting significance of *Illuminate*. It does not settle the VAT treatment of aesthetic medicine. It illuminates the path by which that treatment must now be analysed.

In practical terms: a needle may be medical, cosmetic, or both. VAT now asks why it was used.

THE RISKS OF AI AND A LOSS OF PRIVILEGE

David Tipping

Introduction

The rise of large language models (or ‘LLMs’) has been a significant breakthrough for artificial intelligence (‘AI’), and introduced a level of technological sophistication that was not previously possible. It is not surprising, therefore, that services such as ChatGPT, Copilot, Claude and Gemini are increasingly popular. Many people are turning to these services for a variety of reasons, from the mundane to the extraordinary.

In that context, it is unsurprising that the rise of this technology poses new and unforeseen challenges for the legal and tax systems. This article intends to flag just one of those risks: the potential for advice uploaded to a chatbot (such as ChatGPT) to lose the protection of legal privilege, and thereby become susceptible to disclosure. This was raised as a possibility in passing by the immigration and asylum chamber of the Upper Tribunal in *UK v Secretary of*

State for the Home Department [2026] UKUT 81 (IAC) (*UK v Home Department*).

Legal Professional Privilege

By way of background, it is helpful to consider what legal privilege is, and the necessary elements to establish a claim to privilege.

Privilege is the right to resist the compulsory disclosure of information.¹ There are multiple types of privilege, but perhaps the most significant (in the context of tax, at least) is legal professional privilege. Legal professional privilege arises in two, distinct circumstances which can be summarised as follows:

1. Litigation privilege, which applies to communications which was created for the dominant purpose of existing or contemplated litigation.
2. Legal advice privilege, which protects confidential communications between a client and a lawyer made for the purpose of giving and receiving legal advice. The privilege does not extend to

¹ *B v Auckland District Law Society* [2003] 2 AC 736

communications between clients and other professionals (such as accountants) even if that professional is giving legal advice within their competence.²

It is important that information must be confidential in order to attract legal professional privilege. This means that, if a privileged document ceases to be confidential, it also ceases to be privileged.³

AI and Confidentiality

In *UK v Home Department*, the Upper Tribunal was determining whether to report representatives who had provided false case references to it in their written submissions. In the course of that hearing, one of the representatives admitted (at [16]) that they had uploaded draft emails to clients and Home Office documents to ChatGPT in order to produce summaries for clients. This prompted the Upper Tribunal to make the following observation at [21]:

“We also observe that to put client letters and decision letters from the Home Office

² *R (Prudential plc) v Special Commissioner of Income Tax* [2013] UKSC 1.

³ *Serdar Mohammed v Ministry of Defence* [2013] EWHC 4478 at [16](iv).

into an open source AI tool, such as ChatGPT, **is to place this information on the internet in the public domain, and thus to breach client confidentiality and waive legal privilege**, and thus any regulated legal professional or firm that does so would, in addition to needing to bring this to the attention of their regulator, be advised to consult with the Information Commissioner's Office. Closed source AI tools which do not place information in the public domain, such as Microsoft Copilot, are available for tasks such as summarising without these risks.”
(emphasis added)

The Upper Tribunal's focus is on this activity as a regulatory or disciplinary matter for regulated professionals (and rightly so, where this has been done without the client's knowledge or consent). However, it raises a potentially more important issue, which is that the use of these tools could materially and adversely affect a client's position in the course of an enquiry or an appeal.

The loss of privilege may not seem important in the abstract. However, when one considers the broad scope of HMRC's information powers, it becomes clear that the loss of privilege could have significant and adverse consequences for a client.

Privilege and Information Notices

During the course of an investigation, HMRC has extensive powers to obtain the information which it needs, broadly contained in Schedule 36 Finance Act 2008.

Under that legislation, HMRC can (broadly) require a person to provide any document or information that is reasonably required for the purposes of checking a taxpayer's tax position, subject to relatively limited restrictions. This can include advice given by a tax adviser to their client (although only if the demand is made of the client, and not the adviser).⁴ One important limitation is that HMRC cannot require a person to provide privileged information.⁵ This is an important safeguard: it enables lawyers to give full and frank advice without

⁴ Para. 25 Sch. 36 FA 2008.

⁵ Para. 23 Sch. 36 FA 2008.

concern for how the advice could be perceived by HMRC or others.

Suppose that a client (Mr. Smith) has sought legal advice about a particularly complex transaction, and the tax consequences that it would have. Due to the complexity of the issues raised, Mr. Smith uploads the advice to ChatGPT to create a summary for him. If the Upper Tribunal in *UK v Home Department* is correct, this would mean that the advice Mr. Smith received is no longer confidential and, as a result, he can no longer claim privilege over its contents. If HMRC request copies of any advice received in relation to that transaction (as sometimes happens if, for example, HMRC are concerned that a main purpose test applies), Mr. Smith would have no grounds for resisting the information notice. He would be required to provide a copy of the advice he received.

This may prolong HMRC's investigation as they follow-up on matters raised in the advice which were previously not known to them. In the worst case scenario, the advice provided could provide HMRC with the justification to assess Mr. Smith.

Conclusion

The rules around privilege and the use of AI are still in a very early stage. It is inevitable that the courts will need to make decisions about whether and when privilege is lost when using AI. It is possible that, as the legal system becomes more familiar with these new tools, the courts adopt a more flexible approach, such that the use of AI by a lay client does not have such severe consequences.

Nevertheless, the decision in *UK v Home Department* should be a warning. If it is correct, uploading privileged documents to public AI models could cause those documents to lose privilege. In turn, there may be nothing preventing those documents from being obtained by HMRC in the future. Advisers, and their clients, should proceed with caution.

ADVANCED INFORMATION EXCHANGES: EFFORTS TO TACKLE EVASION AND AVOIDANCE THROUGH TAX HAVENS

Lachlan Molesworth

Abstract: This paper explores the efforts and limitations associated with cross-border information exchanges as policy instruments aimed at curbing tax evasion and avoidance facilitated by tax havens. It examines information exchange in promoting transparency and deterring evasion and avoidance activities. It also explores obstacles hindering the effectiveness of such initiatives, including legal, technological, and political aspects.

1 Introduction

Cross-border information exchange has become an almost ubiquitous policy tool in the global efforts to counter tax evasion and avoidance through tax havens, leveraging international cooperation and transparency to undermine the secrecy that shields avoidance activities. In response to the proliferation of the use of tax havens and their role in facilitating untaxed or illicit financial flows in the context of increasingly

mobile capital, governments and international organisations have successfully embraced information exchange mechanisms as a means to enhance transparency and combat tax crimes. This dissertation critically examines the theoretical potential of cross-border information exchange instruments and identifies practical obstacles that impede their effectiveness. This paper focusses on the responsive behaviours of tax evaders and avoiders to restructure asset holdings into assets or structures not captured by existing exchange protocols, revealing emerging weaknesses to existing exchange instruments. In particular, the transfer of traditional disclosable financial assets (such as bank deposits) to indirect real property investments, portfolio investments and digital currencies, are matters that give rise to a need to reform exchange protocols to ensure their effectiveness in fighting harmful tax practices through the use of havens.

2 Role of tax havens in evasion and avoidance activities

Tax havens present a formidable challenge to global fiscal governance by offering environments conducive to tax evasion and avoidance. While there are a variety

of types of tax havens,¹ this paper focuses on havens that exhibit features of low or no rates of taxation for individuals and corporations and traditionally limited information sharing protocols. Since the mid-twentieth century tax havens have evolved to be more than just jurisdictions offering low rates of taxation but rather, what Herbert Pepper writing in 1977 describes as, “fiscal paradises” providing sophisticated platforms to enable complex financial transactions unimpeded by ordinary obligations of disclosure and source- or residence-based taxation.² Milton Grundy writing around the same time famously identified the ease that tax havens could be used to exploit gaps in international tax legislation to avoid tax.³ According to Thomas Rønfeldt, while tax laws have developed to more effectively bring to account income sourced in tax havens, an ongoing threat these countries pose is their privacy laws that complicate efforts of foreign tax authorities to track tax liabilities.⁴ Rønfeldt calls this a

¹ Including no/low tax havens, territorial-base havens, treaty havens and special-feature havens.

² Herbert Pepper, ‘From Tax Haven to Fiscal Paradise’ (1977) B.I.F.D 31, 75.

³ Milton Grundy, ‘Tax Havens’ [1967] B.T.R. 41, 42.

⁴ Thomas Rønfeldt, ‘Tax Havens and Tax Shelters: A Legal View on the Cross-Border Intermediate Holding Companies within the EU’ (2015) 43(4) Intertax 337, 337-8.

“hidden money shelter problem” which he argues continues to materially impact global revenue collection.⁵

3 Development and promise of information exchange protocols

Since Grundy and Pratt wrote on tax havens in the late twentieth-century, significant developments to counter the effectiveness of havens in tax planning and eroding global tax bases have been implemented. Central to these has been the development of information exchange frameworks.

3.1 Tax treaties

The first key class of policy instrument directed at cross-border information exchange is the bilateral tax treaty network. The inception of a treaty model for information exchange can be traced to the League of Nations in the 1920s. According to Xavier Oberson the League’s efforts laid the foundation for bilateral tax treaties facilitating the exchange of information.⁶ These early attempts were limited in scope and

⁵ Thomas Rønfeldt, ‘Hidden Money’ (2015) 43(5) *Intertax* 418, 418-9.

⁶ Xavier Oberson, *International Exchange of Information in Tax Matters* (Edward Elgar, 2015), 4-5.

effectiveness, primarily due to the non-binding nature of obligations, the limited participation of countries and the lack of a global enforcement mechanism.⁷ The OECD later advanced a framework for the exchange of taxpayer information with the 1963 Draft Convention which included an early form of Article 26 on information exchange. The Article was largely overhauled in the 2005 Model revision. The essential features of this provision (which are reflected in Article 26 of the UN Model) include that authorities are obligated to provide information upon request, and in respect of certain categories, automatically including financial account information, including dividend and interest earnings.⁸ Axiomatically this data is essential to the calculation of tax liabilities and therefore assist authorities bring specific taxpayers to account, including in respect of income originating in tax havens.

3.2 Tax information exchange agreements

The second key instrument framework is the network of tax information sharing and agreements (**TIEAs**) based on the OECD's model "Agreement on Exchange

⁷ Oberson (n 6) 5.

⁸ Oberson (n 6) 16.

of Information on Tax Matters” established in 2002.⁹ The model establishes a standard of exchange for information that is broader than under Article 26 of the OECD Model and includes information that is “foreseeably relevant” to the administration of laws in the relevant state.¹⁰ This is generally accepted to include matters relation to business and employment income, estate, inheritance and gift information and more comprehensive information on registered ownership of assets. However, while the foreseeably relevant test provides a breadth to revenue authorities on the types of information they may seek, it is worth noting that some commentators, such as Perla Végh, in fact see this as limiting the promise of these instruments as it means that a revenue authority can only request information if it can demonstrate it is likely relevant to the tax affairs of a *specific* given taxpayer.¹¹

⁹ OECD, *Harmful Tax Competition: An Emerging Global Issues* (1998).

¹⁰ Perla Végh, ‘Towards a Better Exchange of Information’ (2022) ET 394, 401-2.

¹¹ Végh (n 10) 395.

3.3 Multilateral administrative assistance agreements

The third key cross-border information exchange instrument is the multilateral Convention on Multilateral Administrative Assistance in Tax Matters, developed jointly by the OECD and Council of Europe. It was originally signed in 1988 but updated in 2010. It provides a comprehensive framework for the exchange of information between revenue authorities. The 2010 amendments responded to the need to combat offshore tax evasion more effectively by opening it to all countries, thus facilitating its use as a global instrument. Broadly three classes of exchange under the instrument may occur: (1) information on request (foreseeability relevant); (2) automatic exchange of pre-agreed categories, generally including financial information under the Common Reporting Standard; and (3) spontaneous exchange where one country may automatically provide information where it believes this information may be relevant to the other country's tax administration.

3.4 Other policy instruments

Two important information sharing initiatives involved the release of the Common Reporting

Standard (**CRS**) by the OECD in February 2014¹² and Country-By-Country Reporting (**CBC**) in September 2014 as part of BEPS Action 13. Both CRS and CBC are components of the global effort to tackle tax avoidance by improving information exchange. While CBC focuses on transparency of MNEs' operations in different jurisdictions, CRS targets individual tax evasion through undisclosed offshore accounts. Together, these standards represent critical tools in authorities being able to detect tax evasion and avoidance in tax havens by disclosure of financial information.

4 Critical analysis of obstacles and effectiveness of exchange protocols

A root-and-branch review of information exchange protocols presented at the International Fiscal Association (**IFA**) 2020 Congress found on balance that cross-border information exchange instruments had been a success to counteract tax evasion and avoidance, including through havens.¹³ However, the

¹² OECD, *Standard for Automatic Exchange of Financial Account Information in Tax Matters* (2014), 3.

¹³ Tatiana Falcão, Armando Yaffar, 'Exchange of Information: Issues, Use and Collaboration' (2020) 105B Cahiers DFI 195, 202.

report identifies several obstacles that hinder the full realisation of its potential.

4.1 *Limitations of information captured*

Since 2009, more than 3,000 TIEAs have been signed and entered by countries including, importantly, by most jurisdictions generally considered tax havens.¹⁴ Notwithstanding the success of international efforts to have haven jurisdictions enter into exchange agreements, the IFA report and a number of recent commentators posit that rather than successfully deterring tax evaders from continuing to engage in harmful tax practices, the observed consequence is in fact that tax evaders adapt and adopt alternative structures and strategies to avoid detection by revenue authorities.¹⁵ A critical analysis of academics studies reveals two particular weaknesses of the effectiveness of current exchange instruments. First, that tax avoiders will restructure holdings to jurisdictions with the least transparent information exchange rules. Second, that tax avoiders will convert disclosable

¹⁴ Dominika Langenmayr, Lennard Zyska, 'Escaping the exchange of information: Tax evasion via citizenship-by-investment' (2023) 221 *Journal of Public Economics* 1, 1.

¹⁵ Niels Johannesen, Gabriel Zucman, 'The end of bank secrecy? An evaluation of the G20 tax haven crackdown,' (2014) *Am. Econo. J.: Econ. Policy* 6 (1), 65-91, 68-9.

financial holdings to other assets and instruments that sit outside existing information exchange regimes.

With regard to the first identified weakness concerning restructuring of assets, a comprehensive study by Johannesen and Zucman in 2014 concluded that ownership of assets and holdings shifts away from offshore tax havens that improve transparency in favour of remaining less transparent offshore jurisdictions.¹⁶ These findings were broadly consistent with findings of Menkhoff and Miethe analysing bank data between 2003 and 2017, where they identify that following the commitment of a tax haven to implement information exchange there was an observable response in a reduction of deposits in those jurisdictions of 27.5%.¹⁷ However, the authors find that there was no statistically significant corresponding increase in deposits or transfers to transparent jurisdictions. Johannesen and Zucman put this down to the transferrable nature of the typically financial assets which are held in tax havens

¹⁶ Niels Johannesen, Gabriel Zucman, 'The end of bank secrecy? An evaluation of the G20 tax haven crackdown' (2014) *Am. Econo. J.: Econ. Policy* 6(1), 65-91

¹⁷ Jakob Miethe, Lukas Menkhoff, 'Tax evasion in new disguise? Examining tax havens international bank deposits' (2019) *J. Public Econ.*, 176, 53-78, 70.

– that is, it is easy for tax haven assets to simply be transferred to the ‘lowest common denominator’ of exchange jurisdictions. Rather than change the behaviour of tax evaders the primary effect of a tax haven entering an exchange protocol was to bring about a reallocation of deposits to the least compliant jurisdiction. This behavioural response is unsurprising but reveals the weakness of an incomplete network of information exchange protocols. It is not enough that a strong bilateral exchange protocol be entered into; rather it requires all possible haven alternatives to have a corresponding minimum standard in order to change behaviour. To the extent that there remain jurisdictions without a network of exchange agreements that are sufficiently robust, assets will likely flow to those jurisdictions rather than remaining in tax havens that become transparent presenting an obstacle to realising the potential of exchange instruments.

With regard to the second identified weakness concerning the conversion of assets to escape disclosure, a number of leading commentators hypothesise based on studies of empirical data that tax evaders respond to information exchange regulation by converting or transferring bank deposits into other

guises. Menkhoff and Miethe's 2019 study of international bank deposits held in tax havens concluded from an analysis of empirical evidence that the effect of information exchange agreements was that "tax evaders adapt to established information exchange treaties by using new disguises to hide their true income".¹⁸ They argue that their data casts real doubt on the effectiveness of the current information exchange frameworks in tackling tax evasion as the evidence is that tax evaders adapt to regulation by moving deposits into other forms of assets or in structure that avoid disclosure.¹⁹ What this demonstrates is that information exchange may appear to have an immediate effect on the use of tax havens to hold funds or assets for evasion or avoidance purposes but that in fact those assets may be converted and thereby mitigate the effectiveness of cross-border information exchange.

In terms of identifying with precision the weaknesses of existing information exchange agreements, a precise focus on the types of information captured and not captured is required. In this regard a recent study by Johannesen, Miethe and Weishaar undertaken in

¹⁸ Miethe Menkhoff (n 17) 60-1.

¹⁹ Miethe Menkhoff (n 17) 55.

2022 is instructive. Johannesen et al argue that while information exchange has made it harder to hide financial assets offshore in tax havens other asset holdings not captured by exchange instruments are seeing an increased role in tax planning activities and result in relevant income or asset data escaping detection. In particular, the authors point to the absence of a systemic cross-border reporting regime of real estate assets that can facilitate the avoidance or evasion of tax through holding entities in tax havens.²⁰ The authors point to UK data that the implementation of the CRS bank transparency measures reveal a statistically significant decrease in financial assets (principally deposits) held by UK taxpayers in tax havens and a corresponding increase in holdings of UK residential property by foreign entities registered in tax havens.²¹ They focus on the ability to use offshore corporate shell entities to acquire assets such as residential real estate or even artwork to avoid the

²⁰ Niels Johannesen, Jakob Miethe, Daniel Weishaar, ‘Homes incorporated: Offshore ownership of real estate in the U.K.’ (2022) CEPR Press Discussion Paper No. 17738 available at [http://refhub.elsevier.com/S0047-2727\(23\)00047-6/ho160](http://refhub.elsevier.com/S0047-2727(23)00047-6/ho160) (accessed 16 April 2024) 1.

²¹ Johannesen et al (n 20) 6-8.

exchange of financial account information.²²

There are two posited solutions to this issue which carry some persuasion. The first, is that exchange conventions be amended to more comprehensively include indirect asset ownership information (including in particular indirect real property ownership data). This may require improvements to domestic property registers that permit tracing and capture of ultimate ownership information. The second potential solution, is to capture information on origin of funds used for substantial transactions. The availability of datasets containing source fund information will more readily permit tracing of beneficial ownership and income information.

4.2 *Portfolio investment*

Portfolio investment presents a particular challenge for exchange protocols and efforts to fight tax evasion and avoidance. For foreign direct investment, where investors are fewer and identities clearer, information exchange is a valuable and effective means of strengthening tax enforcement. However, portfolio investment through funds registered or resident in tax

²² Johannesen et al (n 20) 9.

havens is more complex. Tanzi and Zee writing recently on the use of investment funds in tax haven jurisdictions discuss the effectiveness of information exchange frameworks, and in so doing differentiate between foreign direct investment and portfolio investment. The authors argue that with portfolio investment, where investors are numerous and less transparent, information exchange protocols still face significant obstacles stemming from the difficulty in (1) identifying underlying investor identities on existing data; and (2) the lack of cooperation from tax havens in sourcing more difficult indirect datasets.²³ The authors point to the opacity of portfolio investors' identities based on existing datasets. Focussing on portfolio investment, the authors also identify the challenge of coordinating information sharing across different tax jurisdictions which is particularly essential with portfolio investment where large numbers of investors might have portfolio interests through complex holding structures. The authors conclude that while information exchange is crucial for the prevention of tax evasion and avoidance through the use of offshore fund structures, current

²³ Vito Tanzi, Howell Zee, 'Taxation in a Borderless World: The Role of Information Exchange' (2000), 28(2) *Intertax* 58-63, 60.

information exchange instruments are not adequate for capturing cross-border portfolio investment income flows.

4.3 Virtual currencies and unregulated markets

An emerging obstacle to the effectiveness of information exchange instruments is the use of virtual currencies, such as cryptocurrencies and digital tokens, which exist in unregulated or semi-regulated markets with limited data availability. Falcão and Yaffar writing on the effectiveness of exchange frameworks identify virtual currencies as a serious emerging risk. The limited regulation of these instruments with no uniform treatment of the taxation of these currencies presents a weakness in the existing exchange protocols and an effective tool to avoid or evade tax. The authors point to the heart of the risk as being that these instruments exist in “a market that can be operated and administered by private parties outside a traditional financial market framework”.²⁴ In particular, it is the anonymity that makes the collection and exchange of information in these markets difficult and increases the risk of tax evasion

²⁴ Falcão and Yaffar (n 13) 241.

and avoidance. While existing exchange protocols comprehensively capture transaction data – through bank and trading accounts and registers – these assets generally sit outside existing regulated exchange frameworks without proper data capture.²⁵ The report notes that most countries still do not even include a cryptocurrency definition in financial regulation.²⁶ A recent report by Biebel and Voje on exchange of information protocols with the European Union found that crypto assets “pose inherent tax challenges with regard to tax avoidance and identifying beneficial ownership”.²⁷ The authors identify that while some efforts in developed jurisdictions have been made to capture digital currency transactions, there is no capture of this data in tax haven countries. These concerns are persuasive and logical – such assets do not sit comfortably within existing mandatory frameworks. In order to overcome this obstacle, exchange protocols must be updated to require countries to capture and exchange digital currency information.

²⁵ Falcão and Yaffar (n 13) 243.

²⁶ Falcão and Yaffar (n 13) 244.

²⁷ Reinhard Biebel and Jasna Voje, “Exchange of information: issues use and collaboration” 248, 250.

6 Conclusion

While cross-border information exchanges promise to make the fight against tax evasion and avoidance easier, and indeed have contributed to increased revenue collection,²⁸ their ability to do so has been limited by a range of limitations. That is unlikely to change until there is a deepening and broadening of the datasets automatically exchanged under existing information exchange protocols. From a practical perspective this would likely require the exchanging of information concerning origin of funds and datasets going to indirect ownership of financial and tangible assets. Authorities would also need to be required to capture emerging financial products such as digital currencies and products. Only with more comprehensive data capture are information exchanges likely to be able to really further counter international tax evasion and avoidance through tax havens.

²⁸ Falcão and Yaffar (n 13) 245.